



COMPTROLLER

UNDER SECRETARY OF DEFENSE  
1100 DEFENSE PENTAGON  
WASHINGTON, DC 20301-1100

NOV 14 2006

MEMORANDUM FOR SECRETARIES OF THE MILITARY DEPARTMENTS  
CHAIRMAN OF THE JOINT CHIEFS OF STAFF  
COMMANDERS OF THE COMBATANT COMMANDS  
INSPECTOR GENERAL OF THE DEPARTMENT OF  
DEFENSE  
DIRECTOR, ADMINISTRATION AND MANAGEMENT  
DIRECTORS OF THE DEFENSE AGENCIES

SUBJECT: Fiscal Year (FY) 2007 Guidance for the Preparation of the Statement of Assurance

Each Department of Defense (DoD) Component must submit to the Secretary of Defense an annual Statement of Assurance (SOA) signed by the Component's Head (or Principal Deputy). This is a long-standing requirement of the Office of Management and Budget Circular No. A-123, "Management's Responsibility for Internal Control," which complies with the "Federal Managers' Financial Integrity Act (FMFIA) of 1982." Your SOAs for FY 2007 must be received **no later than August 31, 2007**.

The annual guidance for preparing your FY 2007 SOA is attached. The guidance is also available on our website at <http://www.dod.mil/comptroller/fmfia/index.html>. Part I of the guidance provides instructions for preparing the Statement of Assurance on the effectiveness of internal controls for programs, administrative activities and operations. Part II provides instructions for preparing the assurance statement on the effectiveness of internal controls over financial reporting. Finally, Part III explains the scorecard criteria for the statement of assurance in FY 2007.

For more information, please contact Ms. Peggy Johnson, the DoD Managers' Internal Controls Program Manager, by e-mail at [peggy.johnson@osd.mil](mailto:peggy.johnson@osd.mil) or commercial (703) 602-0300 ext. 112, DSN 332-0300 ext. 112.



Tina W. Jonas

Attachment:  
As stated

**PART I**

**GUIDELINES**

**FOR PREPARATION OF THE**

**FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT (FMFIA)**

**OVERALL**

**ANNUAL STATEMENT OF ASSURANCE**

**FISCAL YEAR 2007**

# PART I

## TABLE OF CONTENTS

	<u><b>Page</b></u>
Department of Defense (DoD) Requirements for the Consolidated Annual Statement of Assurance (FMFIA Overall and FMFIA Over Financial Reporting) .....	3
FMFIA Overall Statement of Assurance Guidelines .....	5
FMFIA Overall Statement of Assurance When No Statement of Assurance Over Financial Reporting Is Required .....	9
Sample Info Memo .....	9
Conceptualizing a Material Weakness in the FMFIA Overall Process .....	11
Description of the Concept of Reasonable Assurance and How the Evaluation Was Conducted (TAB A).....	13
Material Weakness / Corrective Actions (TAB B) .....	16
Lists of All Uncorrected and Corrected Material Weaknesses (TAB B-1) .....	17
Uncorrected Material Weaknesses Status of Corrective Actions (TAB B-2).....	19
Material Weaknesses Corrected This Period (TAB B-3) .....	23
Instructions for the Principal Staff Assistants Regarding Overall Systemic Weakness(es) .....	26
DoD Internal Control Reporting Functional Categories .....	31

## TABLES AND EXAMPLES

	<u><b>Page</b></u>
TABLE 1 (DoD Components Required to Submit FY 2007 Annual Statement of Assurance for the FMFIA Overall Process) .....	8
Example (TAB B-1).....	18
Example (TAB B-2).....	21
Example (TAB B-3).....	24
Example (TAB C-3) of Transfer to Financial Reporting (For Principal Staff Assistants).....	28

## **Department of Defense Requirements for the Consolidated Annual Statement of Assurance (FMFIA Overall and FMFIA Over Financial Reporting)**

In accordance with the Department of Defense (DoD) Instruction 5010.40, Managers' Internal Control Program Procedures, the DoD Federal Managers' Financial Integrity Act (FMFIA) Overall Process Statement of Assurance will disclose material weaknesses identified through an assessment that tests the effectiveness of the Component's internal controls for the overall program, administrative, and operational activities and describe the plans and schedules to correct those weaknesses. See guidelines beginning on page 5 in Part I of this annual guidance.

Only the Department of Defense (DoD) Components with Financial Statement Reporting Entities (FSREs) that are listed on pages 12-13 in Part II of this annual guidance, will also provide the FMFIA Over Financial Reporting Statement(s) of Assurance on the effectiveness of internal control over financial reporting as a subset to the FMFIA Overall Statement of Assurance for each FSRE. See detailed instructions in Part II of this annual guidance. **The Head (or Principal Deputy) of the Component must sign the statement.** This signature authority may not be delegated below the DoD Component principal deputy.

**Submission Date: DoD Component Heads must submit the Statement(s) of Assurance for both the FMFIA Overall Process and the FMFIA Over Financial Reporting Process, as required, no later than August 31, 2007. ABSOLUTELY NO EXTENSIONS TO THE SUSPENSE DATE WILL BE GIVEN.**

The DoD Component Heads must submit Statements of Assurance following the format and content requirements of this annual guidance. Each Component will provide both electronic and hard copies of its fiscal year (FY) 2007 Statement(s) of Assurance. The electronic version should be emailed to [peggy.johnson@osd.mil](mailto:peggy.johnson@osd.mil). **The electronic version of each Component's Statement of Assurance is required by August 31, 2007.** The mailing address is:

Office of the Under Secretary of Defense (Comptroller)  
Deputy Chief Financial Officer  
Room 3E620, Pentagon  
Washington, DC 20301-1100  
Attention: Managers' Internal Control Program Coordinator

Each Component shall submit **its original (paper) signed copy** of the Statement of Assurance directly to the Secretary of Defense **no later than August 31, 2007.** **ABSOLUTELY NO EXTENSIONS TO THE SUSPENSE DATE WILL BE GIVEN.**

The statement must have the signature of either the Head (or principal deputy) of the DoD Component. The mailing address is:

Honorable Donald H. Rumsfeld  
Secretary of Defense  
1000 Defense Pentagon  
Washington, DC 20301-1000

In addition, information copies of the Statement of Assurance from the Combatant Commands shall be furnished to the Chairman of the Joint Chiefs of Staff. The mailing address is:

General Peter Pace, USMC  
Chairman of the Joint Chiefs of Staff  
9999 Joint Staff Pentagon  
Washington, DC 20318-9999

Since FY 2003, the Department has used a scorecard to grade the performance of the DoD Components' Statements of Assurance. The scorecard grades five categories: 1) report timeliness, 2) format to include accuracy and completeness of the report, 3) extent of Component-wide program execution, 4) extent of Component-wide training conducted, and 5) weakness reporting (full disclosure and prompt resolution of previously reported weaknesses). The scorecard criteria for FY 2007 are contained in Part III of this annual guidance.

Timely reporting is essential. Any Statement of Assurance that is received over 2 calendar days late will receive an amber score in the reporting timeliness category; over 5 calendar days late receives a red score; any statement received over 15 days past the suspense date will receive a black score for a significant reduction of the overall score. Statements significantly late jeopardize the entire Department's ability to meet the Office of Management and Budget deadlines.

Component Heads are encouraged to submit their Statement of Assurance on or in advance of the suspense date of August 31, 2007. Receipt of the Statements of Assurance at least 7 calendar days in advance will receive an extra credit score in the timeliness category.

## **FMFIA Overall Statement of Assurance Guidelines**

The FMFIA Overall Process Statement of Assurance will disclose material weaknesses identified by an assessment of the effectiveness and efficiency of operations and compliance with applicable laws and regulations for the overall program, administrative, and operational activities. This statement will describe the plans and schedules to correct any material weaknesses reported.

The statement is effective ***as of the date the statement is signed***. Material weaknesses should not be reported as closed until all corrective actions have been implemented and a validation of closure accomplished. If a material weakness is expected to be corrected within the 4<sup>th</sup> Quarter (Qtr) of FY 2007 but all actions are not completed when the statement is signed, the DoD Component Head should report the material weakness as still ongoing.

The list of DoD Components required to submit the FMFIA Overall Process Statement of Assurance is on page 8 of Part I of this annual guidance. Each FMFIA Overall Process Statement of Assurance submission shall consist of the following:

1. An INFO MEMO, **addressed to the Secretary of Defense and signed by the Head of the DoD Component, or the Principal Deputy**, providing the assessment by the Component's senior management as to whether there is reasonable assurance that the Component's internal controls are in place, operating effectively, and being used for the overall programs, administrative and operational activities to include the effectiveness and efficiency of operations and compliance with applicable laws and regulations. If the DoD Component is identified as having a FSRE (see Table 1, pages 12 and 13, in Part II of this annual guidance), the DoD Component must also follow the guidelines provided in Part II of this annual guidance. Under the Office of Management and Budget (OMB) Circular A-123, "Management's Responsibility for Internal Control," December 21, 2004, the FMFIA Overall Process Statement of Assurance must take one of the following three forms (see sample info memo on page 9 of Part I):

a. **An unqualified Statement of Assurance** (reasonable assurance with no material weaknesses reported). Each unqualified statement shall provide a firm basis for that position, which the Head (or principal deputy) will summarize in the cover memorandum. TAB A will contain a more extensive explanation of how the assessment helped justify the Head (or principal deputy) of the Component's assertion of an unqualified statement.

b. **A qualified Statement of Assurance** (reasonable assurance with exception of one or more material weakness(es) noted). The cover memorandum must cite the material weaknesses in internal controls that preclude an unqualified statement. TAB B will fully describe all weaknesses, the corrective actions being taken and by whom, and the projected dates of correction for each action.

c. **A Statement of No Assurance** (no reasonable assurance because no assessments conducted or the noted material weaknesses are pervasive). The Head (or principal deputy) shall provide an extensive rationale for this position.

2. TAB A: A description of how the DoD Component conducted its assurance evaluation for the FMFIA Overall Process only and, based on that evaluation, a statement describing how the Head (or principal deputy) achieved this level of reasonable assurance (detailed discussion on pages 13-15 in Part I of this annual guidance). In addition, TAB A should include a brief summary of the most significant actions taken by the DoD Component during FY 2007 to strengthen specific internal controls, the MIC program execution, the internal control training, and other improvements. Examples of other improvements are the protection of government assets, efficiency of operations, conservation of resources, and improvements to customer needs.

3. TAB B-1: A list of the titles of all uncorrected and corrected material weaknesses. See pages 17 and 18 in Part I of this annual guidance.

4. TAB B-2: Detailed narrative descriptions of all uncorrected material weaknesses including the plans and schedules for the corrective action(s). Include those identified during the current year and those disclosed in prior years with updated information. Narratives for updating material weaknesses identified in prior years will explain the rationale for any changes to previously reported corrective milestone dates. See pages 19 through 22 in Part I of this annual guidance.

5. TAB B-3: A brief narrative describing the material weaknesses corrected in the current year, including the most significant actions taken to correct the weakness. This section will include all material weaknesses corrected in FY 2007 that were identified in either current or prior year(s). For each corrected material weakness, the last milestone will describe the method used to validate the corrective action to include a certification that the corrective action has effectively resolved the weakness. See pages 23 through 25 in Part I of this annual guidance.

6. TAB C: **Used only by the Director of Administration and Management in reporting “overall systemic weaknesses” for the Office of the Secretary of Defense Statement of Assurance.** *“Overall systemic weaknesses” are defined as those weaknesses materially affecting internal management controls that warrant reporting to a higher level. Overall systemic weaknesses usually affect multiple DoD Components or are reported by the Principal Staff Assistant as a pervasive problem across the DoD. Overall systemic weaknesses include systemic weaknesses for all functions **EXCEPT** the FINANCIAL REPORTING IMPLEMENTATION AREAS which are functions that directly relate to the financial reporting of Fund Balance with Treasury, Appropriations Received, Investments, Accounts Receivable, Other Materials and Supplies, Inventory, Real Property, Military Equipment, Accounts Payable, Federal Employee Compensation Act Liabilities, Health Care and Environmental Liabilities. Overall systemic weaknesses can include other financial issues as long as these weaknesses are not directly related to the **FINANCIAL REPORTING IMPLEMENTATION AREAS**. The list of overall systemic weaknesses reported by the Department in the FY 2006 DoD Statement of Assurance are on pages 26 through 28 of Part I. The OSD Principal Staff Assistants must identify and/or report to the Director of Administration and Management the status of “overall systemic weaknesses” that fall within*

their area of functional responsibility. The Director of Administration and Management will then consolidate the overall systemic weaknesses and report the status to the Secretary of Defense in the Office of the Secretary of Defense Statement of Assurance using the weakness status format as described in TAB B on pages 16 through 25 in Part I of this annual guidance. The OSD Principal Staff Assistants will include in their FY 2007 Statements of Assurance addressed to the OSD Director of Administration and Management any new overall systemic weaknesses or the status of all existing overall systemic weaknesses, for which the OSD Principal Staff Assistant is the functional proponent to include all “overall systemic weaknesses” listed for FY 2006 on pages 26 through 28 in Part I of this annual guidance. For any weakness listed on pages 26 through 28 that has previously been transferred to the FINANCIAL REPORTING IMPLEMENTATION AREAS or is being transferred in FY 2007, the OSD Principal Staff Assistant will close the weakness and state in the weakness status format in the last milestone of the corrective actions, *“The reporting status is being transferred to the DoD Senior Assessment Team.”* See example of format on pages 28 through 30, Part I of this annual guidance. If the FY 2007 Office of the Secretary of Defense Statement of Assurance incorrectly reports a weakness in the Overall Systemic Weakness Section, that should be under the oversight of the DoD Senior Assessment Team, the DoD Managers’ Internal Control Program Manager will notify the OSD Managers’ Internal Control Program Manager at the beginning of FY 2008 to correct the mistake by closing the weakness in the upcoming FY 2008 Statement of Assurance indicating as the last corrective action of the weakness status report that, *“The reporting status is being transferred to the DoD Senior Assessment Team.”* It is imperative that reports for overall systemic weaknesses be clearly identified as overall systemic weaknesses, with the title, **OVERALL SYSTEMIC WEAKNESS REPORTING.**



**TABLE 1**  
(DoD Components Required to Submit FY 2007  
Annual Statement of Assurance for the FMFIA Overall Process)

Office of the Secretary of Defense  
Department of the Army  
Department of the Navy (Includes Marine Corps)  
Department of the Air Force  
Joint Staff  
United States European Command  
North American Aerospace Defense / United States Northern Command  
United States Transportation Command  
United States Pacific Command  
United States Southern Command  
United States Joint Forces Command  
United States Central Command  
United States Special Operations Command  
United States Strategic Command  
Inspector General, Department of Defense  
Defense Advanced Research Projects Agency  
Defense Business Transformation Agency  
Defense Commissary Agency  
Defense Contract Audit Agency  
Defense Contract Management Agency  
Defense Finance and Accounting Service  
Defense Information Systems Agency  
Defense Intelligence Agency  
Defense Logistics Agency  
Defense Security Cooperation Agency  
Defense Security Service  
Defense Threat Reduction Agency  
Missile Defense Agency  
National Defense University  
National Geospatial-Intelligence Agency  
National Security Agency / Central Security Service  
Pentagon Force Protection Agency  
Uniformed Services University of the Health Sciences

**FMFIA OVERALL STATEMENT OF ASSURANCE WHEN NO STATEMENT OF  
ASSURANCE OVER FINANCIAL REPORTING IS REQUIRED  
Sample**

**INFO MEMO**

MEMORANDUM FOR THE SECRETARY OF DEFENSE (Components must address the cover memorandum to the Secretary of Defense and must follow format for memorandum as prescribed. If addressed to other than the Secretary of Defense, the memorandum may be returned for revision. If the format is not followed as prescribed, revisions risk delays that could adversely affect the accuracy and timeliness of the Secretary of Defense Statement of Assurance to the OMB, Congress, and the President.)

SUBJECT: Annual Statement Required under the Federal Managers' Financial Integrity Act (FMFIA)

- As **(title of Component Head or Principal Deputy)** of **(name of Component)**, I recognize that the **(name of Component's)** management is responsible for establishing and maintaining effective internal controls to meet the objectives of the Federal Managers' Financial Integrity Act (FMFIA). I am able to provide **[the statement must take one of three forms: "an unqualified statement of reasonable assurance" (no material weaknesses being reported); "a qualified statement of reasonable assurance" (one or more material weaknesses being reported); or "no assurance" (no processes in place to assess the internal controls or pervasive material weaknesses that cannot be assessed)]** that the **(name of Component)** internal controls meet the objectives of FMFIA overall programs, administrative, and operations **(if qualified)** with the exception of **(number)** material weakness(es) described in TAB B. These material weaknesses were found in the internal controls over the effectiveness and efficiency of operations and compliance with applicable laws and regulations as of the date of this memorandum. Other than the material weaknesses noted in TAB B, the internal controls were operating effectively and no other material weaknesses were found in the design or operation of the internal controls.
- **Component's statement will include the following paragraph only if the Component identified material weaknesses, either in the current fiscal year or past fiscal years:**
- The **[Component]** FMFIA overall evaluation did identify material weaknesses. TAB B-1 is a list of material weaknesses that still require corrective action and those corrected during the period. TAB B-2 is an individual narrative for each uncorrected material weakness listed in TAB B-1. **(Include the previous two sentences if your Component has any uncorrected material weaknesses.)** TAB B-3 is an individual narrative for each material weakness corrected during the period. **(Include the previous sentence if your Component corrected any material weaknesses during the past fiscal year.)**

- **[(The statement must include the following if the form of the statement is unqualified or qualified.)** TAB A provides additional information on how the **(name of Component)** conducted the assessment of internal controls for the FMFIA overall process, which was conducted according to OMB Circular A-123, Management's Responsibility for Internal Control. In addition, TAB A provides a summary of the significant accomplishments and actions taken to improve Component internal controls during the past year.]

**(Signature of Component Head or Principal Deputy)**

- **[An example of a cover memorandum demonstrating a FMFIA Overall Process Statement of Assurance that also includes one or more assurance statements for the FMFIA Over Financial Reporting Process Statement(s) of Assurance begins on page 5 of Part II.]**

## **Conceptualizing a Material Weakness in the FMFIA Overall Process**

Each manager is responsible for establishing internal controls in his or her area of responsibility and continuously assessing the effectiveness of the internal controls to meet intended mission objectives. DoD Components are expected to conduct at minimum, annual independent assessments that may identify internal control weaknesses; however, management should avoid duplication of ongoing reviews or inspections of internal controls. Continuous monitoring, supplemented by periodic assessments, should be documented in enough detail to support management's assertion as to the effectiveness of internal controls.

Managers should identify deficiencies in internal controls. One or more deficiencies in the design or operation of an internal control that management believes are significant and could adversely affect the organization's ability to meet its mission objectives is a reportable condition. The organization will track reportable conditions internally. A reportable condition that the DoD Component Head determines to be significant enough to be reported outside the Component will be considered a material weakness and included in the FMFIA Overall Process Statement of Assurance. The designation of a material weakness is a management judgment that should be based on relative risk. Although the appearance of a weakness in an audit report does not necessarily warrant reporting it as a material weakness in the Component's FMFIA Overall Process Statement of Assurance, OMB Circular A-123 states that serious consideration should be given to the views of the Inspector General. The bottom line is that the weakness is considered material if the Head (or principal deputy) of the Component determines to include the weakness in the FMFIA Overall Process Statement of Assurance submitted to the Secretary of Defense. Therefore, the decision of whether a weakness is "material" is leadership's judgment except for "significant deficiencies" that were identified under the Federal Information Security Management Act (FISMA); these must be reported as material weaknesses in the FMFIA Overall Process Statement of Assurance.

OMB Circular A-123, Management's Responsibility for Internal Control, page 14, Section IV, B., "Identification of Deficiencies," states that managers are encouraged to report material weaknesses as this reflects positively on the agency's commitment to recognize and address management problems. Neglecting to report material weaknesses reflects adversely on the agency and could place the agency at risk.

An overall systemic weakness is a material weakness that is reported by more than one Component or reported by the Principal Staff Assistant which has the responsibility for the issue. Once reported, the same material or systemic weakness should never reappear as a new, re-titled weakness in future FMFIA Overall Process Statements of Assurance even when a subsequent audit report has revealed new instances of the same problem. Instead, the original weakness should reflect that it was completed. The new instance should retain the same name as the original weakness but show a new date identified. For example, consider a material or systemic weakness that a Component originally identified in FY 2000 and corrected in FY 2003. Then in FY 2007, audit reports identify related problems and the component wants to report it as a new material weakness in FY 2007. The material weakness should retain the same title as the original, but the "Year Identified" date would now appear as FY 2007, not FY 2000.

Weaknesses that slip year after year and do not meet the targeted correction dates reflect negatively on the Department's commitment to improvement. Therefore, Components should resolve material weaknesses as quickly as possible and ensure that the targeted correction dates are met.

Components must be careful in defining and setting the scope of the material weakness problem. For example, if the deficiency is due to inadequate controls for effectively implementing the equal employment opportunity (EEO) requirements, the reported weakness and milestones should address that problem. It is incorrect to define the problem in a broad category such as the civilian hiring practices, and then include corrective actions that narrowly address the deficiency in the EEO requirements. In this case, the definition and specification of the weakness scope is too broad.

Sometimes it is preferable to address several related problems in one weakness statement. However, Components should be cautious when defining a weakness. For example, in addition to the hypothetical weakness stated above, a Component might have concluded that there are other control problems related to civilian hiring practices. Combining several problems and reporting one weakness under a broad statement that the Component will correct deficiencies in civilian hiring practices may overstate the dimensions of the weakness. Confine the weakness statement to the scope of the specific problem(s) addressed. Consolidation of like weaknesses into a single comprehensive weakness is encouraged only when appropriate conditions apply. Avoid bundling a number of related weaknesses for the principal purpose of reducing the number of material weaknesses reported. Weaknesses defined too broadly are very difficult to resolve and usually result in repeatedly missed targeted correction dates.

For FY 2007, the Department will not require Components to identify or report Section 4 nonconformance weaknesses. Instead, the Department will develop a Defense-wide reporting based on the progress made by the Business Management Modernization Program.

## DESCRIPTION OF THE CONCEPT OF REASONABLE ASSURANCE AND HOW THE EVALUATION WAS CONDUCTED

### (TAB A)

This section describes the concept of reasonable assurance and the evaluation process used. In TAB A, use the following template to help describe the concept of reasonable assurance:

The **(name of Component)** senior management evaluated the system of internal accounting and administrative controls, in effect during the fiscal year as of the date of this memorandum, according to the guidance in Office of Management and Budget (OMB) Circular No. A-123, "Management's Responsibility for Internal Control," December 21, 2004. The OMB guidelines were issued in conjunction with the Comptroller General of the United States, as required by the "Federal Managers' Financial Integrity Act of 1982." Included is an evaluation of whether the system of internal accounting and administrative control for the **(name of Component)** is in compliance with standards prescribed by the Comptroller General. **NOTE: If a self-evaluation of the system of internal accounting and administrative control was not conducted, or the evaluation was insufficient when compared to the Guidelines, indicate that fact and provide an explanation.**

The objectives of the system of internal accounting and administrative control of the **(name of Component)** are to provide reasonable assurance that:

The obligations and costs are in compliance with applicable law;

Funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and

Revenues and expenditures applicable to agency operations are properly recorded and accounted for, to permit the preparation of reliable accounting, financial and statistical reports and to maintain accountability over the assets.

The evaluation of internal controls extends to every responsibility and activity undertaken by **(name of Component)** and applies to program, administrative and operational controls. Furthermore, the concept of reasonable assurance recognizes that (1) the cost of internal controls should not exceed the benefits expected to be derived and (2) the benefits include reducing the risk associated with failing to achieve the stated objectives. Moreover, errors or irregularities may occur and not be detected because of inherent limitations in any system of internal accounting and administrative control, including those limitations resulting from resource constraints, congressional restrictions, and other factors. Finally, projection of any system evaluation to future periods is subject to risk that procedures may be inadequate because of changes in conditions, or that the degree of compliance with procedures may deteriorate. Therefore, this statement of reasonable assurance is provided within the limits of the preceding description.

The **(name of Component)** evaluated the system of internal control in accordance with the guidelines identified above. The results indicate that the system of internal accounting and administrative control of the **(name of Component)** in effect during the fiscal year **(year, i.e., 2007)** as of the date of this memorandum, taken as a whole, **(complies/does not comply)** with

the requirement to provide reasonable assurance that the above mentioned objectives were achieved. This position on reasonable assurance is within the limits described in the preceding paragraph.

The **(Name of Component)** evaluated its system of internal accounting and administrative control using the following process for conducting the evaluation. **[The below is a list of items the Component should consider including to explain how the Component conducted the evaluation.]**

1. The progress achieved in institutionalizing internal controls (i.e., a brief description of how the Component Managers' Internal Control (MIC) Program is applied or reviewed for compliance also could be used here if it has already been fully implemented);
2. Any improvements to MIC Program coverage (address the expected benefits and related costs of control procedures using estimates and managerial judgment);
3. A description of the problems encountered in implementing the MIC Program;
4. Other considerations (e.g., resource constraints, technological bottlenecks, and operational or mission considerations) affecting the MIC Program;
5. Any deviations from the process as outlined in the OMB Circular A-123;
6. Any special concerns addressed in reports by the Inspector General (IG), DoD or Component audit, investigation, inspection and/or internal review organizations regarding MIC Program progress, needs, and/or problems;
7. Methods, mechanisms, or techniques employed in the discovery or execution phases of the program. The following are examples of methods, mechanisms, or techniques:
  - a. MIC Program weakness tracking system (number of weaknesses and milestones);
  - b. Component Inspector General or Audit Service findings;
  - c. Reports of Component internal reviews and inspections;
  - d. IG, DoD reports and reviews;
  - e. Most significant MIC Program accomplishments achieved during FY 2007;
  - f. MIC Program training;
  - g. MIC Program performance standards (e.g., such as those found in the GAO Internal Control Management and Evaluation Tool (August 2001));

- h. Government Accountability Office (GAO) reports and reviews;
- i. Review of Office of the Secretary of Defense (OSD) Functional Proponent Proposals (e.g., systemic weaknesses);
- j. Information Technology initiatives;
- k. MIC Program references in directives, regulations, and other guidance;
- l. Congressional reviews and hearings;
- m. Command or other subordinate organization "Letters of Assurance;"
- n. Productivity statistics;
- o. Defense Regional Interservice Support studies;
- p. Management reviews in other functional areas (e.g., procurement, communications and intelligence. financial, or environmental);
- q. Quality Assurance reviews;
- r. "Hot Line" reports.
- s. Evidence that assessments have been conducted by including examples of deficiencies found that do not warrant reporting as material weaknesses and the actions taken or planned to resolve these deficiencies. Use the following format:

**Description of Issue:** Reconciliation of the Government Purchase Card Accounts.

**Accomplishments:**

- By standardizing processes, limiting the number of purchase cardholders, and using automated tools, the elapsed time from billing period closing to forwarding the account reconciliation to the Defense Finance and Accounting Service (DFAS) has been reduced from 12 days to 4 days.
- The reduction of process time enables DFAS to pay the U.S. Bank within established parameters, thus preventing payment of interest and allowing the Defense Commissary Agency to earn rebates.
- Improvements in oversight capabilities has drastically reduced the agency's delinquency rates and increased rebate dollars.
- FY 2007 1<sup>st</sup> Quarter rebates totaled \$124,000 compared to FY 2006 1<sup>st</sup> Quarter of \$65,000.



## **MATERIAL WEAKNESS / CORRECTIVE ACTIONS**

### **(TAB B)**

**(Also for TABs C, D, E, F and so on, for FMFIA Over Financial Reporting)**

This section presents internal control weakness information in three subset tabs:

1. A listing of the titles of all uncorrected and corrected material weaknesses as of the conclusion of the current period along with actual and projected correction dates. (TAB B-1)
2. Narratives for the uncorrected material weaknesses identified in the summary listing. (TAB B-2)
3. Narratives for all material weaknesses corrected during the current period. (TAB B-3)

The three subset tabs are illustrated on the following pages.

## **LISTS OF ALL UNCORRECTED AND CORRECTED MATERIAL WEAKNESSES**

### **(TAB B-1)**

**(Also for TABs C-1, D-1, E-1, F-1 and so on, for FMFIA Over Financial Reporting)**

Components should prepare this section after completing both TABs B-2 and TAB B-3 since it is a summary listing of TAB B-2 and TAB B-3 weakness titles and correction dates. Divide the material weakness titles into three groupings: Uncorrected Weaknesses Identified During the Period (the current fiscal year); Uncorrected Weaknesses Identified During Prior Periods; and Corrected Weaknesses Identified During All Periods.

**Uncorrected Weaknesses Identified During the Period:** (List by DoD functional category, in the order provided on pages 31-33 in Part I of this annual guidance.)

<u>Title</u>	<u>Quarter (QTR) and Fiscal Year (FY)</u> <u>Targeted Correction Date</u>	<u>Page #</u>
(1)	(4)	(5)

**Uncorrected Weaknesses Identified During Prior Periods:** (List by DoD functional category, in the order provided on pages 31-33 in Part I of this annual guidance.)

<u>Title</u>	<u>Year</u> <u>First</u> <u>Reported</u>	<u>Correction QTR &amp; FY Date</u>		<u>Page #</u>
		<u>Per Last</u> <u>Annual</u> <u>Statement</u>	<u>Per This</u> <u>Annual</u> <u>Statement</u>	
(1)	(2)	(3)	(4)	(5)

**Corrected Weaknesses Identified During All Periods:** (List by DoD functional category, in the order provided on pages 31-33 in Part I of this annual guidance.)

<u>Title</u>	<u>Year</u> <u>First</u> <u>Reported</u>	<u>Page #</u>
	(2)	(5)
(1)	(2)	(5)

#### **NOTES:**

- (1) Titles should be identical to those found on the material weakness narratives provided in TAB B-2 or B-3.
- (2) Use the fiscal year in which this weakness was first reported.
- (3) This is the **quarter and fiscal year** noted as the targeted date for correction of the material weakness in the Component's FY 2006 Annual Statement.
- (4) This is the **quarter and fiscal year** noted as the targeted date for correction of the material weakness in the Component's FY 2007 Annual Statement.
- (5) The page number is that of the first page of the material weakness narrative as found in TAB B-2 or B-3.

## TAB B-1 EXAMPLE

### (TAB B-1) LISTS OF ALL UNCORRECTED AND CORRECTED MATERIAL WEAKNESSES

#### Uncorrected Weaknesses Identified During the Period:

<u>Title</u>	<u>Quarter (QTR) and Fiscal Year (FY) Targeted Correction Date</u>	<u>Page #</u>
<u>Category: Communications and/or Intelligence and/or Security</u> Lack of Security Policy	2nd Qtr, FY 2008	TAB B-2-1

#### Uncorrected Weaknesses Identified During Prior Periods:

<u>Title</u>	<u>Year First Reported</u>	<u>Correction Qtr &amp; FY Date</u>		<u>Page #</u>
		<u>Per Last Annual Statement</u>	<u>Per This Annual Statement</u>	
<u>Category: Contract Administration</u> Contract Administration of Service Contracts	FY 2003	2 <sup>nd</sup> Qtr, FY 2007	4 <sup>th</sup> Qtr, FY 2009	TAB B-2-6
<u>Category: Information Technology</u> Combating Computer Software Piracy	FY 2003	1 <sup>st</sup> Qtr, FY 2007	1 <sup>st</sup> Qtr, FY 2008	TAB B-2-8

#### Corrected Weaknesses Identified During All Periods:

<u>Title</u>	<u>Year First Reported</u>	<u>Page #</u>
<u>Category: Supply Operations</u> Independent Logistics Assessment (ILA) Process.	FY 2004	TAB B-3-1
<u>Category: Force Readiness</u> Inadequate Procedures for Projecting Training Requirements	FY 2005	TAB B-3-5

## UNCORRECTED MATERIAL WEAKNESSES STATUS OF CORRECTIVE ACTIONS

### (TAB B-2)

(Also for TABs C-2, D-2, E-2, F-2 and so on, for FMFIA Over Financial Reporting)

This attachment should provide a narrative for each uncorrected material weakness identified by the Component for which corrective actions have NOT been completed, regardless of the year of first reporting. Begin each weakness at the top of a new page. Group the narratives contained in TAB B-2 into two subsections: “Uncorrected Weaknesses Identified During the Period” and “Uncorrected Weaknesses Identified During Prior Periods.”

The numbers and letters used below are provided only to assist in your comprehension of this guidance and should not appear in your statement of assurance for either the FMFIA Overall Process or the FMFIA Over Financial Reporting Process. Only the headings should appear.

**Spell out acronyms the first time they are used in each individual material weakness narrative.** Deviation from this guidance may require your Component to revise and resubmit the DoD Component statement. A delay due to a required revision has the potential to adversely affect the accuracy of the DoD statement.

Simplify your material weakness status reports to the greatest extent possible by summarizing what previously was presented in detail. **Each uncorrected material weakness report should be three pages or less. Avoid use of the passive voice, minimize the use of acronyms, and use “bullets” to describe both the actions taken and planned. Narratives should be succinct, void of technical jargon, and easy for the general public to interpret.**

The narratives shall follow the format below. **USE THE HEADINGS INDICATED BELOW IN BOLD TYPE IN THE EXACT SEQUENCE.** Do not exclude sections, if they are not applicable, simply note “N/A” following the heading. Do not include the numbers that appear before the headings below; they are included only to assist in your comprehension of this guidance. An example of TAB B-2 is shown on pages 21-22 in Part I of this guidance.

1. **Title and Description of Issue:** Provide title and confine the weakness description to three sentences if possible.
2. **Functional Category:** Indicate one of the 16 functional categories provided on pages 31-33 in Part I of this guidance, e.g., “Force Readiness.” For the FMFIA Over Financial Reporting, identify the focus area, e.g., “Financial Reporting, Fund Balance with Treasury.”
3. **Component:** Indicate which Component is reporting the weakness for the FMFIA Overall. For the FMFIA Over Financial Reporting, indicate the Component and the name of the Financial Statement Reporting Entity, e.g., Army Working Capital Fund.

4. **Senior Official In Charge:** Identify the name and title of the senior official in charge of ensuring this weakness is resolved according to targeted milestone projections. Per the DoD Instruction 5010.40, Managers' Internal Control Program Procedures, dated January 4, 2006, page 15, para E2.21, a senior official is a member of the highest level of management or leadership of the agency or Component. The DoD Component Heads will require the addition of a critical element to the performance appraisal plan of the senior official that indicates the effective and timely resolution of the material or systemic weakness.

5. **Pace of Corrective Action: (For all targeted correction dates, Components must show both the Quarter and Fiscal Year, e.g., 1<sup>st</sup> Qtr, FY 2007, 2<sup>nd</sup> Qtr, FY 2008, etc.)**

Year Identified: Fiscal year of the annual statement of assurance in which Component first reported the weakness.

Original Targeted Correction Date: Quarter and fiscal year of the targeted correction date as Component first reported it.

Targeted Correction Date in Last Year's Report: Quarter and fiscal year of the targeted correction date as it was reported in the Component's FY 2006 annual FMFIA Statement of Assurance.

Current Target Date: Quarter and fiscal year of targeted correction date per this report.

6. **Reason For Change in Date:** Reason for change in quarter and fiscal year of Current Target Date from the Target Correction Date in Last Report as indicated in item #5 above. If applicable, the reason for change should include a brief description of the impact (cost, operation) of any delay in correcting the weakness.

7. **Validation Indicator:** Briefly indicate the methodology that Components will use to certify the effectiveness of the corrective action(s) and the projected date that the certification will take place. In addition, indicate the role that the Inspector General, DoD or Component Audit Service will play in verification of the corrective action.

8. **Results Indicator:** Describe key results that have been or will be achieved in terms of performance measures. Performance measures are quantitative and/or qualitative measures that determine the benefits derived or will be derived from the corrective action and the overall impact of the correction on operations. If monetary benefits are determinable, state that information here. **NOTE: Specifically identify one or two defined performance measures or defined results that will be used to determine successful completion of the proposed remedial effort.**

9. **Source(s) Identifying Weakness:** Use the following other applicable sources: (a) MIC Program Evaluation; (b) IG, DoD; (c) Component Audit Service; (d) GAO; (e) Component internal review organization; (f) Component IG; or (g) Other. When audit findings are the source of weakness identification, identify the title, number and date of the document in which the weakness was identified. If the weakness was identified by more than one source, list all identifying sources in order of significance.

10. **Major Milestones to Include Progress to Date:** Use a milestone chart indicating actions taken and actions planned for the future. Separate milestones into three categories: (a) Completed Milestones, (b) Planned Milestones for Fiscal Year 2008, and (c) Planned Milestones Beyond Fiscal Year 2008. List only major milestones in chronological order by milestone completion date with the terminal milestone listed last. Provide the quarter and fiscal year that each major milestone is projected to be accomplished. Any corrective actions reported in the FY 2006 Performance and Accountability Report as a sample corrective action, must be reported each year until resolved indicating the revised targeted completion date (quarter and fiscal year) or that it is completed. The terminal milestone is the final corrective action, and **should either be or include the validation that the weakness is corrected.**

## **TAB B-2 EXAMPLE**

**(TAB B-2)**

### **UNCORRECTED MATERIAL WEAKNESS STATUS OF CORRECTIVE ACTIONS**

#### **“Uncorrected Weaknesses Identified During Prior Periods”**

**Title and Description of Issue:** Contract Administration of Service Contracts. There is a significant weakness in administering service contracts which includes ineffective planning for quality assurance requirements and inadequate training. A lack of surveillance plans has resulted in no systematic inspection system or effective documentation of contract performance. Procedures for validating and approving contractor invoices sometimes were inadequate and responsibilities and processes for approving invoices were not properly defined.

**Functional Category:** Contract Administration

**Component:** Army

**Senior Official In Charge:** Mr. Robert Taylor, Principal Deputy, Assistant Secretary of the Army (Acquisition, Logistics and Technology)

#### **Pace of Corrective Action:**

**Year Identified:** FY 2003

**Original Targeted Correction Date:** 2<sup>nd</sup> Qtr, FY 2005

**Target Correction Date in Last Year's Report:** 4<sup>th</sup> Qtr, FY 2009

**Current Target Date:** 4<sup>th</sup> Qtr, FY 2009

**Reason for Change in Date:** N/A

**Validation Indicator:** The United States Army Audit Agency (USAAA) will review the effectiveness of these corrective actions in resolving the material weakness and track milestone completion.

**Results Indicator:** The Army has addressed every USAAA finding and initiated corrective action.

**Source(s) Identifying Weakness:** USAAA audit report dated September 23, 2002, "Managing Service Contracts," Audit Report A-2002-0580-AMA.

**Major Milestones to Include Progress to Date:**

**A. Completed Milestones:**

<u>Date:</u>	<u>Milestone:</u>
Completed	Instructed contracting officers to orient evaluators on the specific types of contracts and specific contract links. Clarified existing guidance on quality assurance surveillance plans. Recommended to Major Command (MACOMs) that they review guidance on surveillance when performing contract management reviews. Issued guidance to require contracting officers to periodically review the Contracting Officer Representative (COR) contract files and provide the review results to the activity director.

**B. Planned Milestones for Fiscal Year 2008:**

<u>Date:</u>	<u>Milestone:</u>
2 <sup>nd</sup> Qtr, FY 2008	Issue guidance to the acquisition community instructing contracting officers to establish the appropriate responsibilities and limitations for appointment letters.
3 <sup>rd</sup> Qtr, FY 2008	USAAA review and validate that the weakness is corrected.

**C. Planned Milestones Beyond Fiscal Year 2008: N/A**

## **MATERIAL WEAKNESSES CORRECTED THIS PERIOD**

### **(TAB B-3)**

**(Also for TABs C-3, D-3, E-3, F-3 and so on, for FMFIA Over Financial Reporting)**

Use TAB B-3 to provide a narrative for each material weakness for which corrective actions were completed in FY 2007. Begin each material weakness narrative at the top of a new page. Group information into two subsections: "Identified During the Period" and "Identified During Prior Periods."

For weaknesses appearing in TAB B-3 use the format and data requirements identified for TAB B-2, Item 10, "Major Milestones to Include Progress to Date," however, it should only reflect completed milestones.



## TAB B-3 EXAMPLE

### (TAB B-3) MATERIAL WEAKNESSES CORRECTED THIS PERIOD “Identified During Prior Periods”

**Title and Description of Issue:** Independent Logistics Assessment (ILA) Process. The Navy did not effectively implement the ILA Process. Specifically, Program Executive Offices (PEOs) and Systems Commands (SYSCOMs) did not perform a significant number of ILAs, and did not always disclose results or the basis of logistics certifications to Milestone Decision Authorities. Ambiguous language and vague references in the policy documents did not support effective implementation and implied that performing ILAs was optimal. This adversely impacted the Assistant Secretary of the Navy’s (Research, Development and Acquisition) strategic goals of improving business processes and improving warfighter satisfaction.

**Functional Category:** Supply Operations

**Component:** Navy

**Senior Official in Charge:** Mr. John Paul Jones, Deputy Director of Supply and Acquisitions, Navy

**Pace of Corrective Action:**

Year Identified: FY 2004

Original Targeted Correction Date: 2<sup>nd</sup> Qtr, FY 2005

Targeted Correction Date in Last Year’s Report: 4<sup>th</sup> Qtr, FY 2007

Current Target Date: N/A

**Reason for Change in Date:** N/A

**Validation Indicator:** All corrective action(s) were certified by an internal review audit.

**Results Indicator:** Overall, the number of ILAs performed would be accurate, and the results or the basis of the logistics certification would be disclosed to the appropriate parties for making informed decisions.

**Source(s) Identifying the Weakness:** Naval Audit Service (NAVAUDSVC, NAVAUDSVC Report No. N2000-0027, “Independent Logistics Assessment Process,” June 27, 2000.

## **Major Milestones to Include Progress to Date:**

### **A. Completed Milestones:**

<u>Date:</u>	<u>Milestone:</u>
Completed	Revised Navy acquisition policy to clearly state: (a) whether or not performing independent assessments of logistics is a requirement, and is the basis for logistics certification; (b) the desired outcome of the ILA process, and (c) whether or not use of a Chief of Naval Operations (CNO) – validated assessment process is required.
Completed	Revised ILA policy to: (a) clearly articulate the desired outcome of the ILA process; (b) clarify the full scope of individual implementation procedures which include the overall management of ILAs and all associated responsibilities; (c) clearly define procedures for submitting the ILA implementation procedures for validation; and (d) provide guidelines for development and implementation that ensure timely and effective supportability review and an opportunity for the decision process prior to initial operational capability.
Completed	Revised SECNAVINST 4105.1, which addresses ILAs in detail, to provide additional guidance to SYSCOMS, PEOs, and Program Managers.
Completed	Validation occurred through an on-site internal review audit.

TAB C  
(PRINCIPAL STAFF ASSISTANTS ONLY)

INSTRUCTIONS FOR THE PRINCIPAL STAFF ASSISTANTS  
REGARDING OVERALL SYSTEMIC WEAKNESS(ES)

*“Overall systemic weaknesses” are defined as those weaknesses materially affecting internal management controls that warrant reporting to a higher level. Overall systemic weaknesses usually affect multiple DoD Components or are reported by the Principal Staff Assistant as a pervasive problem across the Department. Overall systemic weaknesses include systemic weaknesses for all functions EXCEPT the FINANCIAL REPORTING IMPLEMENTATION AREAS which are functions that directly relate to the financial reporting of Fund Balance with Treasury, Appropriations Received, Investments, Accounts Receivable, Other Materials and Supplies, Inventory, Real Property, Military Equipment, Accounts Payable, Federal Employee Compensation Act Liabilities, Health Care and Environmental Liabilities. Overall systemic weaknesses can include financial issues as long as these weaknesses are not directly related to the FINANCIAL REPORTING IMPLEMENTATION AREAS listed above. The eleven overall systemic weaknesses listed below were reported by the Department of Defense in the FY 2006 DoD Statement of Assurance. The list includes the title, description and an indication of whether the weakness will be transferred to the FINANCIAL REPORTING IMPLEMENTATION AREAS. The Principal Staff Assistants are required to report the status of all below listed overall systemic weaknesses. However, for any weakness being transferred to the FINANCIAL REPORTING IMPLEMENTATION AREAS, the weakness status report will state as the last corrective action that, “The reporting status is being transferred to the DoD Senior Assessment Team.” See example of format, pages 28 through 30, Part I of this annual guidance. **There is no longer any requirement for DoD Components other than the Principal Staff Assistants to address overall systemic weaknesses in their Statements of Assurance unless assisting the Principal Staff Assistants in preparing the weakness status reports.***

Overall systemic weaknesses reported in the FY 2006 DoD Statement of Assurance were:

1. Department of Defense Financial Management Systems and Processes – The Department of Defense financial and business management systems and processes are costly to maintain and operate, not fully integrated, and do not provide information that is reliable, timely, and accurate. In addition, the Department has reported this issue as non-compliance with the Federal Financial Management Improvement Act of 1996 and as non-conformance with Section 4 of the Federal Managers Financial Integrity Act of 1982. The estimated correction date is 4<sup>th</sup> Quarter, FY 2015. (Office of the Under Secretary of Defense (Acquisition, Technology, Logistics) and the Office of the Under Secretary of Defense (Comptroller))
2. Management of Information Technology and Assurance – The Department of Defense information systems are potentially vulnerable to an information warfare attack. In addition, the Department has reported this issue as a “significant deficiency” under the reporting requirements of the Federal Information Security Management Act. The estimated correction date is 3<sup>rd</sup> Quarter, FY 2007. (Office of the Assistant Secretary of Defense (Network Information and Integration))

3. Valuation of General Personal Property – The Department of Defense does not currently meet Federal Accounting Standards for the financial reporting of personal property. Documentation for personal property is neither accurate nor reliable. The estimated correction date is 3<sup>rd</sup> Quarter, FY 2017. (Office of the Assistant Secretary of Defense (Acquisition, Technology and Logistics))
4. Personnel Security Investigations Program – The Department of Defense hiring is adversely affected because personnel security investigations are backlogged. The estimated correction date is 4<sup>th</sup> Quarter, FY 2007. (Office of the Under Secretary of Defense (Intelligence))
5. Real Property Infrastructure – The Department of Defense has not adequately managed the real property infrastructure to halt the deterioration or obsolescence of facilities on military installations. The estimated correction date is 1<sup>st</sup> Quarter, FY 2008. (Office of the Under Secretary of Defense (Acquisition, Technology and Logistics))
6. Government Card Program Management – Instances of misuse, abuse, and fraud in respect to purchase and travel card use, and centrally billed accounts have been attributed to inadequate Department of Defense emphasis on proper use of the cards, poorly enforced controls, and lax oversight. The estimated correction date is 4<sup>th</sup> Quarter, FY 2007. (Office of the Under Secretary of Defense (Acquisition, Technology and Logistics) for Purchase Cards, and Office of the Under Secretary of Defense (Comptroller) for Travel Cards)
7. Valuation of Inventory on Financial Reports – The valuation of inventory is not always correctly reported. The estimated correction date is 4<sup>th</sup> Quarter, FY 2016. (Office of the Under Secretary of Defense (Acquisition, Technology and Logistics)) – This weakness is being transferred to the financial reporting implementation areas in FY 2007. The Principal Staff Assistant must report as closed and indicate as the final corrective action that, *“The reporting status is being transferred to the DoD Senior Assessment Team.”*
8. Improper Use of Non-Department of Defense Contracting Vehicles – Non-Department of Defense contracting vehicles have been used improperly to procure services or supplies. The estimated correction date is 2<sup>nd</sup> Quarter, FY 2007. (Office of the Under Secretary of Defense (Acquisition, Technology and Logistics))
9. Department of Defense Contracting for Services – The Office of the Inspector General, Department of Defense and the Government Accountability Office, have identified deficiencies in the policy for, and the execution of, procurement for services. The estimated correction date is 4<sup>th</sup> Quarter, FY 2007. (Office of the Under Secretary of Defense (Acquisition, Technology and Logistics))
10. Federal Procurement Data Reporting – The new Federal Procurement Data System is not fully functional causing inaccurate procurement reporting data and increased costs required for continued maintenance of legacy systems. The estimated correction date is 2<sup>nd</sup> Quarter, FY 2007. (Office of the Under Secretary of Defense (Acquisition, Technology and Logistics))

11. Department of Defense Accounts Payable – The Department of Defense does not meet accounting standards for the financial reporting of public accounts payable because of its inability to support balances due to a lack of standard procedures for recording, reporting, and reconciling the amounts between the financial, accounting, and reporting systems. The estimated correction date is 4<sup>th</sup> Quarter, FY 2015. (Office of the Under Secretary of Defense (Office of the Under Secretary of Defense (Comptroller)) -- This weakness is being transferred to the financial reporting implementation areas in FY 2007. The Principal Staff Assistant must report as closed and indicate as the final corrective action that, “*The reporting status is being transferred to the DoD Senior Assessment Team.*”

### TAB C-3

#### EXAMPLE OF TRANSFER TO FINANCIAL REPORTING (FOR PRINCIPAL STAFF ASSISTANTS ONLY)

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##### (TAB C-3)

#### UNCORRECTED MATERIAL WEAKNESS STATUS OF CORRECTIVE ACTIONS “Uncorrected Weaknesses Identified During Prior Periods”

1. **Title and Description of Issue:** Valuation of Inventory on Financial Reports. DoD is unable to accurately account for, value, and report inventory on DoD audited financial statements in accordance with generally accepted accounting principals or Federal Accounting Standards Advisory Board (FASAB) Statement of Federal Financial Accounting Standards (SFFAS).
2. **Functional Category:** Comptroller and Supply Operations
3. **Organization:** Department of Defense, OSD OUSD(AT&L)
4. **Senior Official In Charge:** Honorable P. Jackson Bell, Deputy Under Secretary of Defense, Logistics and Materiel Readiness
5. **Pace of Corrective Action:**  
  
**Year Identified:** FY 2003  
  
**Original Targeted Correction Date:** FY 2006  
  
**Targeted Correction Date in Last Year’s Report:** 4<sup>th</sup> Qtr, FY 2006  
  
**Current Target Date:** N/A
6. **Reason for Change in Date:** None
7. **Appropriation/Account Number:** This uncorrected weakness impacts all appropriation account numbers that fund the purchase and repair of inventory.

**8. Validation Indicator:**

- Management assertions that inventory is ready for audit.
- Department of Defense Inspector General (DoDIG) assessment.
- Unqualified audit opinions.

**9. Results Indicator:** Management assertions that inventory is ready for audit. DoDIG and Service Audit Agency or other auditor assertions that: inventory systems and interfaces are compliant; all required assets are recorded in inventory systems, including those in transit or temporarily located at contractor facilities; reported assets do exist; and valuation of capital assets is accurate and can be substantiated.

**10. Source Document:** DoDIG, Independent Auditor's Report on the Department of Defense Fiscal Year 2003 Agency-Wide Principal Financial Statements (Report No. D-2004-036), dated December 10, 2003. This report identified a reportable condition, that is material, exists in the area of inventory.

**11. Major Milestones to Include Progress to Date:**

**A. Complete Milestones:**

<u>Date:</u>	<u>Milestone:</u>
N/A	Updated the Department of Defense Financial Management Regulation, Volume 11B, Chapter 5.
4 <sup>th</sup> Qtr, FY 2003	Issued policy for "Accounting for Inventory Held for Repair in Working Capital Funds" (USD(C) memorandum dated August 4, 2003).
N/A	Convened an Inventory Working Group, co-chaired by OUSD(C) and OUSD(AT&L), charged with developing a baseline for inventory valuation, establishing methodologies for valuing inventory, and testing the existence and completeness assertions.
N/A	Developed proposed methodologies for valuing inventory; identified systems that are compliant with Moving Average Cost (MAC) inventory valuation and that can sustain MAC valuations; developed proposed processes to baseline compliant systems using MAC methodology and to sustain the baselines; and developed proposed timelines and approaches to completing baselines for all systems, and for testing existence and completeness assertions.
N/A	Worked with the FASAB to interpret and apply SFFAS to the Department's processes.

1 <sup>st</sup> Qtr, FY 2004	Issued update to policy on unique identification of assets (USD(AT&L) memorandum, dated December 22, 2003, subject: Revision of Update to Policy for Unique Identification (UID) of Tangible Items — New Equipment, Major Modifications, and Reprourement of Equipment and Spares”).
2 <sup>nd</sup> Qtr, FY 2004	Issued interim Defense Federal Acquisition Regulation Supplement (DFARS) on IUID (USD(AT&L) memorandum, dated January 13, 2004, “Item Unique Identification and Valuation”).
2 <sup>nd</sup> Qtr, FY 2004	Issued policy on Radio Frequency Identification (USD(AT&L) memorandum, dated February 20, 2004, subject: Radio Frequency Identification (RFID) Policy Update”).
3 <sup>rd</sup> Qtr, FY 2005	Published DFARS clause governing application of passive RFID in Federal Register for public comments in April 2005.
3 <sup>rd</sup> Qtr, FY 2005	Issued final IUID rule published for DFARS Subpart 211.274, Unique Item Identification and Valuation in April 2005.
N/A	Valuation requirements included in the Enterprise Transition Plan.
N/A	Milestones for completion included in the Financial Improvement Audit and Readiness (FIAR) Plan that is monitored by OUSD(C).

**B. Planned Milestones for FY 2007: N/A**

The reporting status is being transferred to the DoD Senior Assessment Team.

## **DoD Internal Control Reporting Functional Categories**

Group material weaknesses, both uncorrected and corrected, by the DoD functional category designations listed and defined below.

1. Research, Development, Test, and Evaluation. The basic project definition, approval, and transition from basic research through development, test, and evaluation and all DoD and contractor operations involved in accomplishing the project work, excluding the support functions covered in separate reporting categories such as Procurement and Contract Administration.
2. Major Systems Acquisition. Items designated as major systems and are subject to the procedures of the Defense Acquisition Board, the Military Services Acquisition Review Councils, or the Selected Acquisition Reporting System. DoDD 5000.1, "The Defense Acquisition System," May 12, 2003, may be helpful when evaluating a weakness for inclusion in this category.
3. Procurement. The decisions to purchase items and services with certain actions to award and amend contracts (e.g., contractual provisions, type of contract, invitation to bid, independent Government cost estimate, technical specifications, evaluation and selection process, pricing, and reporting).
4. Contract Administration. The fulfillment of contractual requirements including performance and delivery, quality control and testing to meet specifications, performance acceptance, billing and payment controls, justification for contractual amendments, and actions to protect the best interests of the Government.
5. Force Readiness. The operational readiness capability of combat and combat support (both Active and Reserve) forces based on analyses of the use of resources to attain required combat capability or readiness levels.
6. Manufacturing, Maintenance, and Repair. The management and operation of in-house and contractor-operated facilities performing maintenance and repair and/or installation of modifications to materiel, equipment, and supplies. Includes depot and arsenal-type facilities as well as intermediate and unit levels of military organizations.
7. Supply Operations. The supply operations at the wholesale (depot and inventory control point) level from the initial determination of materiel requirements through receipt, storage, issue reporting, and inventory control (excluding the procurement of materials and supplies). Covers all supply operations at retail (customer) level, including the accountability and control for supplies and equipment of all commodities in the supply accounts of all units and organizations (excluding the procurement of materiel, equipment, and supplies).
8. Property Management. Construction, rehabilitation, modernization, expansion, improvement, management, and control over real and installed property, and facilities (both military and civil works construction) and includes all phases of property life-cycle



management. Also covers disposal actions for all materiel, equipment, and supplies including the Defense Reutilization and Marketing System.

9. Communications and/or Intelligence and/or Security. The plans, operations, systems, and management activities for accomplishing the communications and intelligence missions and safeguarding classified resources (not peripheral assets and support functions covered by other reporting categories). Also covers the DoD programs for protection of classified information.

10. Information Technology. The design, development, testing, approval, deployment, use, and security of automated information systems (using a combination of computer hardware, software, data or telecommunications that performs functions such as collecting, processing, storing, transmitting or displaying information) and other technologies for processing management information. This includes requirements for justification of equipment and software. The DoDD 8000.1, "Management of DoD Information Resources and Information Technology," February 27, 2002, may be helpful when evaluating a weakness for inclusion in this category.

11. Personnel and/or Organization Management. Authorizations, recruitment, training, assignment, use, development, and management of military and civilian personnel of the Department of Defense. Also includes the operations of headquarters organizations. Contract personnel are not covered by this category.

12. Comptroller and/or Resource Management. The budget process, finance and accounting, cost analysis, productivity and management improvement, and the general allocation and continuing evaluation of available resources to accomplish mission objectives. Includes pay and allowances for all DoD personnel and all financial management areas not covered by other reporting categories, including those in connection with OMB Circular A-76, Performance of Commercial Activities, May 29, 2003.

13. Support Services. All support service functions financed from appropriated funds not covered by the other reporting categories such as healthcare, veterinary care, and legal and public affairs services. All nonappropriated fund activities are also covered by this category.

14. Security Assistance. Management of DoD Foreign Military Sales, Grant Aid, and International Military Education and Training Programs.

15. Other (Primarily Transportation). All functional responsibilities not contained in sections 1. through 14., including management and use of land, sea, and air transportation for movement of personnel, materiel, supplies, and equipment using both military and civilian sources.

16. Financial Reporting. Processes, procedures, and systems used to prepare, compile, and generate the Department of Defense's financial statements according to Section 3512 of title 31, United States Code; DoDD 8910.1-M, "DoD Procedures for Management of Information Requirements," June 1998; the Federal Accounting Standards Advisory Board (FASAB); the Department of the Treasury Manual Treasury Financial Manual, Volume 1: Federal Agencies; the United States Standard General Ledger (USSGL); OMB Circular No.

A-136, "Financial Reporting Requirements," December 21, 2004; OMB Bulletin No. 01-09, "Form and Content of Agency Financial Statements," September, 25, 2001; and DoDI 7000.14-R, "DoD Financial Management Regulation."

**PART II**

**GUIDELINES**

**FOR PREPARATION OF THE**

**FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT (FMFIA)**

**ANNUAL STATEMENT OF ASSURANCE**

**ON**

**INTERNAL CONTROL OVER FINANCIAL REPORTING**

**PROCESS**

**FISCAL YEAR 2007**

## PART II

### TABLE OF CONTENTS

	<u>Page</u>
<b>Guidelines for Internal Controls Over Financial Reporting FMFIA Statement of Assurance Process</b> .....	3
FMFIA Overall Statement of Assurance When One or More Statement(s) of Assurance Over Financial Reporting is Required .....	5
Sample Cover Memorandum .....	5
<b>Implementing OMB Circular A-123, APPENDIX A</b> .....	14
Reporting Process .....	16
Identifying Key Business and Financial Reporting Processes .....	18
Establishing a Senior Assessment Team .....	19
Preparing Process Flow Charts and Narrative .....	19
Preparing Inherent Risk Assessments .....	21
Identifying Internal Controls .....	25
Performing and Evaluating Tests .....	33
Weakness Dependencies .....	35
Preparing Corrective Action Plans .....	36
Preparing the FMFIA Over Financial Reporting Statement of Assurance .....	39
Glossary .....	75

### TABLES, CHARTS AND EXAMPLES

	<u>Page</u>
Defense Aircraft Agency Statement of Assurance (Example) .....	7
TAB D-1 (Example) .....	8
TAB D-2 (Example) .....	9
TAB D-3 (Example) .....	11
TABLE 1 (Components and Their Financial Statement Reporting Entities Required to Submit FMFIA Over Financial Reporting Process Statement of Assurance) .....	12
TABLE 2 (Matrix of Implementation Areas and Financial Statement Reporting Entities) .....	15
TABLE 3 (Schedule of Deliverables) .....	18
TABLE 4 (Risk Assessment) .....	24
SECTION A (Example of Narrative, Flowcharting, and Organizational Chart) .....	40
SECTION B (Example of Risk Analysis) .....	46
CHART 1 (Defense Aircraft Agency Risk Flowchart) .....	48
TABLE 5 (Drop Down List Selections for Column 7 of Chart 1) .....	54
SECTION C (Example of Internal Control Test and Analysis) .....	58
CHART 2 (Defense Aircraft Agency Control Assessment or Analysis) .....	60
SAMPLE TEST PLANS .....	65
SECTION D (OSD Analyst Checklists for accepting Component Deliverables) .....	69

## **GUIDELINES FOR INTERNAL CONTROL OVER FINANCIAL REPORTING FMFIA STATEMENT OF ASSURANCE PROCESS**

The Heads of the Department of Defense (DoD) Components shown in Table 1 on pages 12 and 13 of Part II, are required to provide the **Secretary of Defense** a FMFIA Statement of Assurance on the effectiveness of Internal Control Over Financial Reporting (ICOFR). This statement must be based on an assessment strictly following the requirements of Office of Management and Budget (OMB) Circular A-123, Appendix A; the Chief Financial Officers Council (CFOC) Implementation Guide; and this annual guidance. The assessments of internal controls within the FMFIA Over Financial Reporting process may disclose material weaknesses identified in the reliability of financial reporting within the financial reporting process. This statement will describe the plans and schedules to correct any material weaknesses reported using the same format for the material weaknesses status reports as provided on pages 16 through 25 of Part I of this annual guidance. **The Head (or principal deputy) of the Component must sign the statement.** This signature authority may not be delegated below the level of DoD Component principal deputy.

The statement will cover the one year period from 1 July 2006 through 30 June 2007, and be effective *as of June 30<sup>th</sup> of the fiscal year (FY) 2007*. Any financial material weaknesses previously reported in the overall FMFIA Statement of Assurance (SOA) should not be automatically transferred to the ICOFR SOA. Subject weaknesses may be transferred when test results, performed according to ICOFR requirements and properly documented, disclose the weakness. If a material weakness is expected to be corrected within the 4<sup>th</sup> Quarter (Qtr) of FY 2007 but all actions are not completed as of June 30<sup>th</sup>, the DoD Component Head should report the material weakness as still ongoing.

Each Statement of Assurance submission shall consist of the following:

1. An info memo, as described on pages 5 through 7 of Part II, shall be **addressed to the Secretary of Defense and signed by the Head of the DoD Component, or the principal deputy**. As the example info memo on page 7 of Part II shows, ICOFR will be presented in separate paragraph(s) on the same info memo as the FMFIA Overall Process Statement of Assurance. Therefore, the Head of the Component will only be required to sign one info memo regardless of the number of Financial Statement Reporting Entities (FSREs) for which the Component must provide financial reporting assurance. A separate paragraph for each statement of assurance over financial reporting will provide the assessment by the Component's senior management as to whether there is reasonable assurance that the Component's internal controls are in place, operating effectively, and being used for the financial reporting of each FSRE according to the OMB Circular A-123, "Management's Responsibility for Internal Control, Appendix A" in one of three forms as discussed below. In some cases, the ICOFR assurance may not have the same level of assurance as the FMFIA Overall, e.g., the Component could have an unqualified assurance on the overall and a qualified assurance on the financial reporting for the FSRE. In another example, the Component could have a qualified assurance on the overall and an unqualified assurance for the financial reporting for FSRE #1, but then no assurance on the financial reporting for FSRE #2. Regardless of the number of FSREs, a separate paragraph should cover the assurance level for the financial reporting of each FSRE.

- a. **An Unqualified Statement of Assurance** (reasonable assurance that internal controls over financial reporting are effective, with no material weaknesses reported). Each unqualified statement shall provide a firm basis for that position, which the Head (or principal deputy) will summarize in the cover memorandum.

b. A Qualified Statement of Assurance (reasonable assurance that internal control over financial reporting is effective with exception of one or more material weakness(es) noted). The cover memorandum must cite the material weakness(es) in internal control that precludes an unqualified statement.

c. A Statement of No Assurance (no reasonable assurance because no assessments conducted or the noted material weaknesses are pervasive). The Head (or principal deputy) shall provide an extensive rationale for this position.

2. TABs D-1, E-1, F-1, and so on: For each FSRE, provide a list of the titles of all uncorrected and corrected material weaknesses. Use the same format as described on pages 17 and 18 in Part I. The numbering of the tabs will begin with TAB D because TAB B is for the material weaknesses of the FMFIA Overall and TAB C is reserved for systemic weakness write-ups by the OSD Component discussed on pages 26 through 30 in Part I of the annual guidance. If the Component has three FSREs and each has material weaknesses that are being reported, TAB D-1 can provide the material weakness information for FSRE #1, TAB E-1 is for FSRE #2, and TAB F-1 is for FSRE #3. Each tab must reflect the name of the FSRE for which it applies.

3. TABs D-2, E-2, F-2, and so on (Uncorrected Weaknesses): For each FSRE, provide detailed narrative descriptions of all uncorrected material weaknesses including the plans and schedules for the corrective actions. Use the instructions on pages 19 through 22 in Part I of this annual guidance.

4. TABs D-3, E-3, F-3, and so on (Corrected Weaknesses): For each FSRE, provide a brief narrative describing the material weaknesses corrected in the current year, including the most significant actions taken to correct the weakness. Use the instructions on pages 23 through 25 in Part I of this annual guidance.

An example of the FMFIA Over Financial Reporting Statement of Assurance for the fictitious Defense Aircraft Agency General Fund is shown on page 7 of Part II.

Examples of Tabs D-1, D-2 and D-3 are shown on pages 8, 9, 10, and 11 respectively, of Part II in this annual guidance.

**FMFIA OVERALL STATEMENT OF ASSURANCE WHEN ONE OR MORE  
STATEMENT(S) OF ASSURANCE OVER FINANCIAL REPORTING IS REQUIRED**  
**Sample**

**INFO MEMO**

MEMORANDUM FOR THE SECRETARY OF DEFENSE (Components must address the info memo to the Secretary of Defense. If addressed to other than the Secretary of Defense, the memorandum will be returned for revision. Revisions risk delays that could adversely affect the accuracy and timeliness of the Secretary of Defense Statement of Assurance to the OMB, Congress, and the President.)

SUBJECT: Annual Statement Required under the Federal Managers' Financial Integrity Act (FMFIA) of 1982

- As (title of Component Head or Principal Deputy) of (name of Component), I recognize that the (name of Component's) management is responsible for establishing and maintaining effective internal controls to meet the objectives of the FMFIA. I am able to provide [the statement must take one of three forms: "an unqualified statement of reasonable assurance" (no material weaknesses being reported); "a qualified statement of reasonable assurance" (one or more material weaknesses being reported); or "no assurance" (no processes in place to assess the internal controls or pervasive material weaknesses that cannot be assessed)] that the (name of Component) internal controls meet the objectives of FMFIA overall programs, administrative and operational, (if qualified) with the exception of (number) material weakness(es) described in TAB B. These material weaknesses were found in the internal controls over the effectiveness and efficiency of operations and compliance with applicable laws and regulations as of the date of this memorandum. Other than the material weaknesses noted in TAB B, the internal controls were operating effectively and no other material weaknesses were found in the design or operation of the internal controls.
- Component's statement will include the following paragraph if the Component identified material weaknesses, either in the current fiscal year or past fiscal years:
- The [Component] FMFIA overall evaluation did identify material weaknesses. TAB B-1 is a list of material weaknesses that still require corrective action and those corrected during the period. TAB B-2 is an individual narrative for each uncorrected material weakness listed in TAB B-1. (Include the previous two sentences if your Component has uncorrected material weaknesses.) TAB B-3 is an individual narrative for each material weakness corrected during the period. (Include the previous sentence if your Component corrected any material weaknesses during the past fiscal year.)
- [(The statement must include the following if the form of the statement is unqualified or qualified.) TAB A provides additional information on how the (name of Component) conducted the assessment of internal controls for the FMFIA overall process, which was conducted according to OMB Circular A-123, Management's Responsibility for Internal Control. In addition, TAB A provides a summary of the significant accomplishments and actions taken to improve Component internal controls during the past year.]

- If applicable, the Component will include a separate paragraph stating the level of assurance for each Financial Statement Reporting Entity under the Component Head's purview.
- In addition, the [name of Component] conducted an internal control assessment of the effectiveness of the [Financial Statement Reporting Entity name's] internal control over financial reporting for the following implementation area(s): [Components will list the implementation areas assessed based on the implementation areas listed in TABLE 2 on page 14 of Part II, e.g., "military equipment," "real property," etc.]. The assessment of the implementation areas was conducted in strict compliance with the OMB Circular A-123, Appendix A, as directed by DoD guidance under the oversight of the Senior Assessment Team, which is maintaining complete records of the assessment documentation. Based on the results of this evaluation, I am able to provide [the statement must take one of three forms: "an unqualified statement of assurance" (no material weaknesses being reported); "a qualified statement of assurance" (one or more material weaknesses being reported); or "no assurance" (no processes in place to assess the internal controls or pervasive material weaknesses that cannot be assessed)] that the (name of Component's) internal control over financial reporting implementation areas as of June 30, 2007, was operating effectively [(if qualified "with the exception of (number) material weakness(es) described in TAB D) (or if more than one financial statement reporting entity (E, F, and so on)). These material weaknesses were found in the internal controls over the reliability of financial reporting as of June 30, 2007. Other than the material weaknesses noted in TAB D (or if more than one financial statement reporting entity (E, F, and so on)), the internal controls were operating effectively and no other material weaknesses were found in the design or operation of the internal controls over financial reporting for the [name of the Financial Statement Reporting Entity]. Areas that are not inside the implementation areas listed above were not assessed. Therefore, I can provide no assurance on areas that are not within the above listed implementation areas for the [name of the Financial Statement Reporting Entity].
- The Component's statement will include the following paragraph if the Component identified material weaknesses over financial reporting for one or more financial statement reporting entities, either in the current fiscal year or past fiscal years:
- The [name of the Financial Statement Reporting Entity] weaknesses are described in Tab D. TAB D-1 [or "TAB E-1," "F-1," and so on, for each Financial Statement Reporting Entity requires a separate group of TABs for the material weaknesses], is a list of material weaknesses that still require corrective action and those corrected during the period. TAB D-2 [or "TAB E-2," "F-2," and so on] is an individual narrative for each uncorrected material weakness listed in TAB D-1 [or "TAB E-1," "F-1," and so on]. (Include the previous two sentences if your Component has uncorrected material weaknesses.) TAB D-3 [or "TAB E-3," "F-3," and so on], is an individual narrative for each material weakness corrected during the period. (Include the previous sentence if your Component corrected any material weaknesses during the past fiscal year.)

(Signature of Component Head or Principal Deputy)



**Example**  
**FMFIA OVERALL STATEMENT OF ASSURANCE WHEN ONE OR MORE**  
**STATEMENT(S) OF ASSURANCE OVER FINANCIAL REPORTING IS REQUIRED**  
**INFO MEMO**

MEMORANDUM FOR THE SECRETARY OF DEFENSE

SUBJECT: Annual Statement Required under the Federal Managers' Financial Integrity Act (FMFIA) of 1982

- As Director of the Defense Aircraft Agency, I recognize that the Defense Aircraft Agency management is responsible for establishing and maintaining effective internal controls to meet the objectives of the FMFIA. I am able to provide a qualified statement of reasonable assurance that the Defense Aircraft Agency's internal controls meet the objectives of the FMFIA overall programs, administrative and operational.
- TAB A provides additional information on how the Defense Aircraft Agency conducted the assessment of internal controls for the FMFIA overall process, which was conducted according to OMB Circular A-123, "Management's Responsibility for Internal Control."
- In addition, the Defense Aircraft Agency conducted an internal control assessment of the effectiveness of the Defense Aircraft Agency General Fund's internal control over financial reporting for the following implementation areas: Fund Balance with Treasury (FBWT), Accounts Receivable, Operating Materials and Supplies (OM&S), Real Property and Military Equipment. The assessment of the implementation areas was conducted in strict compliance with the OMB Circular A-123, Appendix A, under the oversight of the Senior Assessment Team, which is maintaining complete records of the assessment documentation. Based on the results of this evaluation, I am able to provide a qualified statement of assurance that the Defense Aircraft Agency General Fund's internal control over financial reporting implementation areas as of June 30, 2007, was operating effectively with the exception of the two material weaknesses described in TAB D. These material weaknesses were found in the internal controls over the reliability of financial reporting as of June 30, 2007. Other than the material weaknesses noted in TAB D, the internal controls were operating effectively and no other material weaknesses were found in the design or operation of the internal controls over financial reporting for the Defense Aircraft Agency General Fund. Areas that are not inside the implementation areas listed above were not assessed. Therefore, I can provide no assurance on areas that are not within the implementation areas for the Defense Aircraft Agency General Fund listed above.
- The Defense Aircraft Agency General Fund material weaknesses are described in Tab D. TAB D-1 is a list of material weaknesses that still require corrective action and those corrected during the period for the Defense Aircraft Agency General Fund. TAB D-2 is an individual narrative for each uncorrected material weakness listed in TAB D-1. TAB D-3 is an individual narrative for each material weakness corrected during the period.

Jane Deer  
Director, Defense Aircraft Agency

[Below are examples of TAB D-1 (Lists of All Uncorrected and Corrected Material Weaknesses), TAB D-2 (Uncorrected Material Weaknesses Status of Corrective Actions), and TAB D-3 (Material Weaknesses Corrected This Period) which correspond with the example memorandum above on page 7. For instructions on how to complete TAB D-1, D-2 and D-3, see pages 16 through 25 of Part I.]

**Defense Aircraft Agency General Fund**

**(TAB D-1)  
LISTS OF ALL UNCORRECTED AND CORRECTED MATERIAL WEAKNESSES**

**Uncorrected Weaknesses Identified During the Period:**

<b>Title</b>	<b>Quarter (QTR) and Fiscal Year (FY) Targeted Correction Date</b>	<b>Page #</b>
<u>Category: Financial Reporting</u> All costs are not captured. Customer invoiced for incorrect amount of goods or services received.	2 <sup>nd</sup> Qtr, FY 2008	TAB D-2-1

**Uncorrected Weaknesses Identified During Prior Periods:**

<b>Title</b>	<b>Year First Reported</b>	<b><u>Correction QTR &amp; FY Date</u></b>		<b>Page #</b>
		<b>Per Last Annual Statement</b>	<b>Per This Annual Statement</b>	
N/A	N/A	N/A	N/A	N/A

**Corrected Weaknesses Identified During All Periods:**

<b>Title</b>	<b>Year First Reported</b>	<b>Page #</b>
<u>Category: Financial Reporting</u> Requesting Component and Performing DoD Component do not reconcile receivables and payables, advances to and advances from, and revenue and expenses (or capitalized assets) in the same accounting period.	FY 2005	TAB D-3-1

**Defense Aircraft Agency General Fund**

**(TAB D-2)**

**UNCORRECTED MATERIAL WEAKNESSES STATUS CORRECTIVE ACTIONS**

**“Uncorrected Weaknesses Identified During the Period”**

**D-2-1**

**Title and Description of Issue:** All costs not captured to appropriate orders. Customer invoiced for incorrect amount of goods or services received. The inability to reconcile invoice with customer orders may lead to misstatement of Accounts Receivable.

**Functional Category:** Financial Reporting, Accounts Receivable

**Component:** Defense Aircraft Agency (DAA) General Fund

**Senior Official In Charge:** Ms. Buck Fawn, Comptroller, Defense Aircraft Agency

**Pace of Corrective Action:**

**Year Identified:** FY 2007

**Original Targeted Correction Date:** 2<sup>nd</sup> Qtr, FY 2008

**Targeted Correction Date in Last Year's Report:** N/A

**Current Target Date:** 2<sup>nd</sup> Qtr, FY 2008

**Reason for Change in Date:** N/A

**Validation Indicator:** All costs will be captured to projects. Monthly reconciliation of costs to DAA projects will result in variance of less than 5 per cent.

**Results Indicator:** Reduced billing errors, more accurate Accounts Receivable reporting.

**Source(s) Identifying Weakness:** Control Test results, June 2007

**Major Milestones to Include Progress to Date:**

**A. Completed Milestones:**

**Date:**

Completed

**Milestone:**

Evaluated current accounting system capabilities for capturing costs.

Developed preliminary reconciliation process.

**B. Planned Milestones for Fiscal Year 2007:**

**Date:**

3<sup>rd</sup> Qtr, FY 2007

**Milestone:**

Develop and issue reconciliation procedures.

**C. Planned Milestones Beyond Fiscal Year 2007:**

Date:

Milestone:

2<sup>nd</sup> Qtr, FY 2008

Train employees on new procedures and implement.

**Defense Aircraft Agency General Fund**

**(TAB D-3)**

**MATERIAL WEAKNESSES CORRECTED THIS PERIOD**

**D-3-1**

**Title and Description of Issue:** Requesting Component and Performing DoD Component do not reconcile receivables and payables, advances to and advances from, and revenue and expenses in the same accounting period. This may result in financial reporting misstatements.

**Functional Category:** Financial Reporting, Accounts Receivable

**Component:** Defense Aircraft Agency (DAA) General Fund

**Senior Official in Charge:** Mr. Buck Fawn, Comptroller, Defense Aircraft Agency

**Pace of Corrective Action:**

**Year Identified:** FY 2005

**Original Targeted Correction Date:** 3rd Qtr, FY 2007

**Targeted Correction Date in Last Year's Report:** N/A

**Current Target Date:** N/A

**Reason for Change in Date:** N/A

**Validation Indicator:** Receivables/Payables balance, advances to and from balance, revenues and expenses are reflected accurately in correct period.

**Results Indicator:** A benchmark of at least 98% of instances where Requesting Component and Performing DoD Component reconcile receivables and payables, advances to and advances from, and revenue and expenses (Or capitalized assets) in the same accounting period. Variances can be explained.

**Source(s) Identifying Weakness:** Control Tests, May 2007

**Major Milestones to Include Progress to Date:**

**A. Completed Milestones:**

<u>Date:</u>	<u>Milestone:</u>
Completed	Implemented process that required reconciliation between Requesting Component's and Performing DoD Component's receivables and payables, advances to and advances from, and revenue and expenses in the same accounting period.
Completed	Management represents that reconciliation results in financial reports that are properly classified, described, and disclosed.

## Components and Their Financial Statement Reporting Entities Required to Submit FMFIA over Financial Reporting Process Statement of Assurance

**(TABLE 1)**

Table 1 describes the listing of the 18 Components who are to submit, as a subset of the FMFIA Overall Process Statements of Assurance to the Secretary of Defense, the FMFIA Over Financial Reporting Statements of Assurance, based on the review of internal control over financial reporting performed by their Financial Statement Reporting Entity(ies).<sup>1</sup>

<b>Table 1</b>	
<b>Component</b>	<b>Financial Statement Reporting Entity (FSRE) and Its Parent Subcomponent</b>
1. Office of the Secretary of Defense (OSD) (Director of Administration and Management for OSD)	1. Under Secretary of Defense (Comptroller) for DoD-wide Compilation
	2. Under Secretary of Defense (Acquisition, Technology, & Logistics)
	3. Military Retirement Trust Fund (MRTF) General Fund (GF)/ Under Secretary of Defense (Personnel and Readiness (P&R))
	4. Medicare Eligible Retirement Health Care Fund (MERHCF) GF/ Assistant Secretary of Defense (Health Affairs)/ Under Secretary of Defense (P&R)
	5. Defense Health Program (DHP) GF/ Assistant Secretary of Defense (Health Affairs)/ Under Secretary of Defense (P&R) / Service Medical Activity (SMA)
	6. Defense Health Program (DHP) GF/ Assistant Secretary of Defense (Health Affairs)/ Under Secretary of Defense (P&R) / Tricare Management Activity (TMA))
	7. Chemical Biological and Defense Program (CBDP) GF/ Deputy Under Secretary of Defense (Laboratories and Basic Sciences)/ Under Secretary of Defense (Acquisition, Technology and Logistics (AT&L))
2. Department (Dept.) of the Army	8. Army GF
	9. Army Working Capital Fund (WCF)
	10. United States Army Corps of Engineers (USACE)
3. Dept. of the Navy	11. Navy GF
	12. Navy WCF
	13. Marine Corps GF
	14. Marine Corps WCF
4. Dept. of the Air Force	15. Air Force GF
	16. Air Force WCF
5. United States Special Operations Command (USSOCOM)	17. USSOCOM GF

<sup>1</sup> The Financial Statement Reporting Entities (FSREs) are the organizations required by either the Office of Management and Budget (OMB) or the Department of Defense to produce stand-alone financial statements for the DoD Components.

<b>Table 1 Continued</b>	
<b>Component</b>	<b>Financial Statement Reporting Entity (FSRE) and Its Parent Subcomponent</b>
6. Defense Advance Research Projects Agency (DARPA)	18. DARPA GF
7. Defense Commissary Agency (DECA)	19. DECA GF
	20. DECA WCF
8. Defense Contract Audit Agency (DCAA)	21. DCAA GF
9. Defense Finance and Accounting Service (DFAS)	22. DFAS GF
	23. DFAS WCF
10. Defense Information Systems Agency (DISA)	24. DISA GF
	25. DISA WCF
11. Defense Intelligence Agency (DIA)	26. DIA
12. Defense Logistics Agency (DLA)	27. DLA GF
	28. DLA WCF
13. Defense Security Service (DSS)	29. DSS GF
14. Defense Threat Reduction Agency (DTRA)	30. DTRA
15. Missile Defense Agency (MDA)	31. MDA
16. National Geo-Spatial Intelligence Agency (NGA)	32. NGA
17. National Reconnaissance Office (NRO)	33. NRO
18. National Security Agency / Central Security Service (NSA/CSS)	34. NSA/CSS

## **IMPLEMENTING OMB CIRCULAR A-123, APPENDIX A**

### **Supporting Your ICOFR Statement of Assurance**

This guidance describes the incremental approach that the DoD is taking in implementing the requirement. To the extent possible, this guidance follows the Implementation Guide for Appendix A issued by the CFOC in July 2005.

Appendix A requires reporting on, based on control test results, the effectiveness of key business process internal controls which significantly affect financial reports. The DoD has determined that limiting assessments to key implementation areas material to DoD would be the best use of resources for the Department and also result in significant benefits for its reporting entities. The scope of the DoD implementation plan will increase annually until it meets the full scope requirement.

Components listed on Table 2 on the next page will be responsible for preparing for the **Secretary of Defense** an annual report on the effectiveness of internal control over financial reporting. This statement, the Statement of Assurance on ICOFR, must be based on procedures prescribed in this guidance and must follow the schedule of deliverables included in this guidance.

Table 2 also presents the required implementation areas for each of the 34 financial reporting entities. The 34 entities are to prepare Internal Control (IC) assessments for only those implementation areas that have an "X" in the box(es) on their lines. For example, Army GF must conduct IC assessments for the following areas: FBWT, Appropriations Received, Investments, Accounts Receivables, OM&S, Real Property, Military Equipment, Accounts Payables, Federal Employees Compensation Act (FECA) Liabilities, Medicare-Eligible Retiree Health Care, and Environmental Liabilities, areas where assertions have been completed, and areas where assertions are to be completed by FY 2007 year-end. The Defense Finance and Accounting Service (DFAS) WCF is required to perform IC assessments on the following areas: Accounts Receivables, OM&S, Real Property, Accounts Payables, FECA Liabilities, and key processes for other material financial statement lines where clean audit opinions have been achieved. All 34 reporting entities are required to provide copies of their IC assessments on assertions completed, and assertions to be completed by FY 2007 year-end.

The Department recognizes that some components are in the process of developing and fielding systems solutions that are intended to remediate known, systemic, material internal control weaknesses. While each area is composed of more than one process and many subprocesses, where system solutions are identified within a component's process, the component is to follow the decision tree on page 17 of Part II to determine at what point the various subprocesses are to implement the Appendix A process.



TABLE 2		Fiscal Year (FY) 2007 Implementation Areas											
FSRE	FBWT	Approps Received	Invest	Accts Rec	OM&S	Inventory	Real Property	MII Equip	Accts Pay	FECA Liabilities	Health Care	Environ. Liabilities	Entities with Unqualified Opinions **
OUSD(C)	X	X	X	X	X	X	X	X	X	X		X	
OUSD(AT&L)					X	X	X	X				X	
Army GF	X	X	X	X	X		X	X	X	X	X	X	
Army WCF	X			X	X	X	X		X	X		X	
USACE	X	X	X	X	X		X		X	X		X	
Air Force GF	X	X		X	X		X	X	X	X	X	X	
Air Force WCF	X			X	X	X	X		X	X		X	
Navy GF	X	X	X	X	X		X	X	X	X	X	X	
Navy WCF	X			X	X	X	X		X	X		X	
Marine Corps GF	X	X		X	X		X		X	X		X	
Marine Corps WCF	X	X		X	X	X	X	X	X	X	X	X	
CBDP	X	X		X					X	X		X	
DARPA	X	X		X	X		X		X	X		X	
DCAA	X	X		X					X	X	X		X
DECA GF	X	X		X	X		X		X	X		X	X
DECA WCF	X	X		X	X	X	X		X	X		X	X
DFAS GF	X	X		X			X		X	X	X		X
DFAS WCF		X		X			X		X	X	X		X
DHP - SMA	X	X		X	X		X		X	X			
DHP - TMA	X	X		X			X		X	X	X		
DIA	X	X		X	X		X		X	X		X	
DISA GF	X	X		X			X		X	X		X	
DISA WCF	X			X	X		X		X	X		X	
DLA GF	X	X		X			X		X	X		X	
DLA WCF	X	X		X	X	X	X		X	X			
DSS GF	X	X		X			X		X	X			
DTRA	X	X		X	X		X		X	X			
MDA	X	X		X	X		X	X	X	X	X		
MERHCF	X	X	X	X					X	X			
MRTF	X	X	X	X					X		X		X
NGA	X	X		X			X		X	X		X	
NRO		X		X					X				
NSA	X	X		X			X		X	X		X	
USSOCOM	X	X		X			X	X	X	X			

## REPORTING PROCESS

The process for the Statement of Assurance on Internal Control Over Financial Reporting (ICOFR) must follow strict rules directed by a TOP DOWN focus as described in the Appendix A of the OMB Circular A-123 and the CFOC Implementation Guide for OMB Circular A-123, Management's Responsibility for Internal Control Appendix A, ICOFR.

The process for preparing the Statement of Assurance (SOA) on ICOFR will be conducted in the following manner:

- Establish an Entity Senior Assessment Team (SAT)
- Prepare process narratives, flow charts, and organizational charts for the assigned implementation areas; obtain SAT Charter and membership list, and component-level environment control document such as a Management Code of Conduct or Ethics Policy.
- Perform Inherent Risk analyses and complete Risk Analysis form through Column 10, and obtain Federal Information Security Management Act (FISMA) Report (if applicable).
- Identify Internal Controls and preliminary Test Plan Methodology: Complete Risk Analysis forms (through Column 13).
- Report Weakness Dependencies in the DoD Financial Improvement and Audit Readiness (FIAR) web-based tool Collaboration Site.
- Create detailed Test Plans (w/o Results) for "Low Risk" controls, or Corrective Action Plans for "High Risk" Controls.
- For components correcting weaknesses for other components, enter Corrective Action Plans in the correcting component's financial improvement plan (FIP) in the FIAR web-base tool.
- Complete the Control Analyses Forms (w/ test results)
- Enter material weakness Corrective Action Plans into FSRE FIP in the DoD Financial Improvement Tool.
- Issue Statement of Assurance on Internal Controls over Financial Reporting

Table 1 in Part II, pages 12 and 13 lists the 18 Components who are to submit the ICOFR SOA based on their management reviews of internal control over financial reporting. The 34 entities are to submit the deliverables A through G shown in Table 3 in Part II, page 18, via their respective Entity Senior Assessment Team, to the Office of the Under Secretary of Defense (Comptroller)'s Financial Improvement and Audit Readiness (FIAR) Directorate, Attention: ICOFR Project Manager. Item H in Part II, page 18, the ICOFR SOA, will be incorporated into the overall FMFIA SOA and submitted to the Secretary of Defense as described on page 3 in Part II.

As noted on page 14, the decision criteria for Appendix A implementation is as follows. The decisions tree is based on the following assumptions: no one size fits all Appendix A approach for DoD; continuous state of discovery and correction; each process documentation initiative must identify the systems that either feed or are the recipient of the output generated from the processes; and full A-123 Appendix A process implementation required prior to any transfer of data from existing process/sub-process/system, independent verification and validation, and any assertion and/or audit.

### OMB Circular A-123, Appendix A, Decision Tree

1. Do you have an unqualified opinion?
  - a. Yes – Apply Appendix A requirements with DoD guidance.
  - b. No – Proceed to question 2.
2. Are the business processes and IT systems working as intended or in the validation/assertion phase?
  - a. Yes – Apply Appendix A requirements with DoD guidance.
  - b. No – Proceed to question 3.
3. Are the business processes and/or systems deficient, but fixable, **without** system dependent solution?
  - a. Yes – Apply Appendix A requirements with DoD guidance to measure corrective actions taken. Return to rule 2.
  - b. No – Proceed to question 4.
4. Are the business processes and/or systems deficient, but fixable, and require a change to an existing system as a solution (SCR)?
  - a. Yes:
    1. Apply Appendix A requirements on business processes and systems that will continue, without modification, with the DoD guidance.
    2. For business processes and/or systems that will require corrective actions, apply Appendix A requirements to the changed business processes and/or systems when the system is at operational/production capability. Proceed to rule 1 upon completion of corrective actions.
  - b. No – Proceed to question 5.
5. Are the business processes and/or systems deficient, not fixable and requiring deployment of a “new” business process or system solution?
  - a. Yes:
    1. Apply Appendix A requirements on business processes and systems that will continue, without modification, with the DoD guidance to assure full implementation upon system deployment.
    2. For business processes and/or systems that will require new system solutions to correct deficient controls, report the deficiency as a material weakness and the system solution as a corrective action plan. (See “Developing Corrective Action Plan” section for further guidance on systems as weakness solutions.) Proceed to rule 1 upon system deployment.
  - b. No – Proceed to question 1.

## Preparing Deliverables

### Identifying Key Business and Financial Reporting Processes

Assessments for the DoD implementation areas must contain a risk analysis of **all material business or process cycles** that affect the particular DoD implementation area. To identify the business cycles that impact the implementation areas, determine what business transactions materially affect related account balances. Ask, “What significantly increases or decreases financial balances in this implementation area?” If DFAS is the organization’s accounting service provider, DFAS may be able to provide assistance in identifying significant types of transactions which represent a material business cycle. For organizations with unqualified audit opinions, all key business processes for all material financial statement lines must be assessed. The DoD has established its level of materiality for FY 2007 as 0.99 percent of adjusted assets for proprietary accounts and 0.99 percent of total budgetary resources for budgetary accounts. Adjusted assets are calculated by subtracting the total intragovernmental assets (as indicated on the balance sheet) from total assets. All financial statement accounts equal to or exceeding the organization’s level of materiality must be assessed.

<b>Table 3</b>	
<b>Schedule of Deliverables</b>	
<b>Due Date for Electronic Submission to FIAR Directorate / ICOFR Manager</b>	<b>Deliverable</b>
	<b><i>Assessing and Documenting</i></b>
December 18, 2006	A. Process Narratives, Flow Charts, and Organizational Charts for the Assigned Implementation Areas, Component-level Environment Control Document such as a Management Code of Conduct or Ethics Policy, SAT membership and Charter
February 1, 2007	B. Risk Analysis Form through Column 10, FISMA Report (if applicable)
March 20, 2007	C. List of Internal Controls and Test Plan Methodology: Completed Risk Analysis Forms (through Column 13)
March 20, 2007	D. Weakness Dependencies Reports (in Collaboration Site)
May 1, 2007	E. Detailed Test Plans (w/o Results) or Corrective Action Plans for “High Risk” Controls
June 1, 2007	F. Corrective Action Plans in Tool for Weakness Reported in Collaboration Site
June 29, 2007	G1. Control Analyses Forms (w/ test results)
	G2. All Corrective Action Plans Entered into DoD Financial Improvement Tool
	<b><i>Reporting</i></b>
September 1, 2007	H. Statement of Assurance on Internal Controls over Financial Reporting

Checklists for component deliverable acceptance are shown in Section D, beginning on page 69 in Part II of this annual guidance.

## **Establishing a Senior Assessment Team**

Each of the 32 reporting entities shall maintain a SAT. The SAT will be composed of senior leadership-level representatives, in decision-making capacities, from implementation functional areas and will be responsible for the preparation of the SOA on ICOFR within the prescribed process. Senior Assessment Teams shall be designated by the head of the Department/Agency. The Senior Assessment Team shall oversee the implementation of Appendix A, OMB Circular A-123.

The SAT shall document the results of the assessments of risk and internal controls for each material business process related to the implementation areas where an “X” appears on Table 2 on page 15 of Part II. The internal controls contained in any material financial or mixed information technology system(s) (e.g., the Defense Property Accountability System (DPAS)) that pertain to any implementation area must also be assessed. This will most likely require coordination with other organizations. Each SAT must ensure that sufficient documentation is retained to explain significant decisions made in identifying material business processes, assessment results, internal control test plans, and the determination of weaknesses to report outside of the entity. Documentation shall also include support for deliverables listed above. Documentation shall be maintained for 3 years and 6 months from the effective date of the ICOFR SOA.

A list of SAT members and their titles and the SAT Charter must be provided to the ICOFR Project Manager with the first deliverable on December 18, 2006. The FSRE Appendix A, Point of Contact (POC) for each Senior Assessment Team shall provide to ICOFR Project Manager two hard copies and one electronic copy of the deliverables A, B, C, and G1, as established in Table 3 on page 18 of Part II no later than the established due dates. Deliverable D, in Table 3 on page 18 of Part II will be submitted on an as-needed basis as determined by the component. Deliverables E and G2, in Table 3 on page 18 of Part II, shall be considered delivered upon successful electronic receipt by the ICOFR Project Manager. For classified data, the POC will contact ICOFR Project Manager for transmitting instructions. Deliverable F, Table 3 on page 18 of Part II, is to be delivered to the reporting entity reporting an approved weakness dependency in the FIAR tool Collaboration Site by the component responsible for developing a corrective action plan to resolve the weakness.

Each hard copy deliverable must be submitted with a transmittal memorandum signed by the chair of the component SAT.

## **Preparing Process Flow Charts and Narrative**

To begin the flowchart process, managers should describe, in narrative form, the steps in their processes which cause an operational event to become a financial transaction. Components must analyze the processes from the point of origin to the financial report and then from the financial report back to the point of origin in order to capture all transaction types, service providers, and systems used in the process.

Based on process narratives, flowchart the processes in a vertical swim-lane format using Microsoft Word or Excel flowcharting capabilities. The flowcharts of the processes must identify the most current key business processes. Only **key processes** are to be flowcharted. Flowcharts should use verbs; i.e., **approved, supported, or validated**.

The financial reporting process from, beginning to end, belongs to the component preparing financial statements, whether or not subprocesses are performed by other organizations. All subprocesses performed by other organizations must be incorporated into the reporting entity's documented process. Where material portions of key processes are performed by organizations other than the reporting entity (a secondary organization), it will be necessary for the reporting entity to obtain from the secondary organization either assertions or flowcharts in order to complete the reporting organization's entire process flowchart. It is recommended that assertions be obtained from organizations external to the Department and flowchart and related, subsequent deliverables assessing the processes be obtained from DoD components. Organizations performing subprocesses are required to provide supporting deliverables described in this guidance to the reporting component at least 2 weeks in advance of the reporting component's due date to DoD. This will provide sufficient time for the reporting component to obtain any clarification it might need from the supporting organization and to incorporate the supporting deliverable into the reporting component's deliverable.

**Note:** Swim lane headers should be names of organizations or offices performing functions within the lane. Header names should never be functions. Flowchart symbols should describe the process. Each flowchart process shown should be numbered and correspond to a numbered step described in the narrative.

Flowchart deliverables shall include the name, phone number and email address of an operational point of contact, flowcharts, process narratives, and the entity's organizational chart. Organization charts must reflect the chain of command for the department(s) described in the flowcharts. All organizational offices shown on the flowcharts should be shown on the organization chart. A footer with the name of the component should be on each page of the deliverable.

To support the organization's control environment, flowchart deliverables shall also include organization's code of conduct, ethics policy, or any component document which would support a positive control environment; a list of SAT members with titles; and the SAT Charter. A sample flowchart process is shown in Section A. The narrative and related flowchart must be at a detailed level for clarification and instructional purposes and represent the types of documents the reporting organization might use for testing and monitoring purposes. Controls, however, should not be flowcharted. They will be identified and assessed in a subsequent step.

Documenting transaction flows accurately is one of the most important steps in the assessment process as it provides the foundation for all subsequent work. Thorough, well-written documents and flowcharts can facilitate the review of key controls. The documentation should reflect an understanding, from beginning to end, of the underlying processes and document flows involved in each major business event or transaction cycle that affect the component's financial reports.

Some process cycles may flow from one component to another through electronic processes. For example, personnel in a Military Service initiate or authorize certain transactions into an information technology (IT) system, and these transactions are received, recorded, and reported by DFAS. Major transaction cycle narratives and flowcharts should identify IT systems involved and the functions the systems perform.

Interviews should be conducted with personnel who have knowledge of the relevant operations to validate that manuals, policies, forms and documents are accurate and being applied.

The narratives should be of sufficient depth to ensure that a reader familiar with ICOFR will understand the process. Transaction cycle flowcharts are not only an efficient way to document the key internal control points in a business process, but they also provide an effective way to confirm the accuracy of the transaction cycle narrative with the process owners, and identify where disparate processes could be standardized.

The following questions may help in preparing the narrative and flowcharts.

Narrative:

1. Does the process narrative have the preparer's name?
2. Is the process owner's name evident on the process narrative?
3. Does the narrative clearly indicate the financial statement accounts and lines impacted by the process including budgetary and revenue accounts?
4. Is the process explained well in the narrative?
5. Does every process identified on the flowchart have an associated description in the narrative?
6. Are the steps in the narrative numbered to facilitate the flowcharting process?

Flowchart:

1. Is there a defined start symbol (either start or connector from another flowchart)?
2. Does the flowchart have a legend that describes the various shapes in the flowchart?
3. Is each shape in the flowchart appropriate (e.g., database reference shows a database shape)?
4. Where is the action being performed (could be externally, internally, systemic application, database, different dept, etc.)?
5. How is the action being performed? Describe what is being utilized to perform the action - report name, database, etc.
6. Do the flowcharts indicate inputs, outputs for each activity?
7. Is the input/output specifically identified (i.e., exact name of query or name of report)?
8. Does the process end at the end of the flowchart? Is there a defined end symbol? Is the next process connector on the flowchart instead of an end symbol?
9. If process flowchart is linked to/from another, have the terminology and common activities been named the same between flowcharts?

A sample Narrative, Flowchart and Organization Chart (**Deliverable A**) is shown in Section A.

## **Preparing Inherent Risk Assessments**

**Inherent Risk:** The susceptibility of a material misstatement, **assuming that there are no related internal controls in place.**

Once key processes have been identified and flowcharted, a risk analysis must be conducted on those processes and the related controls which are designed and operating to mitigate risk(s). Risk assessment documentation will be according to Appendix A of OMB Circular A-123 and the CFOC

Implementation Guide for OMB Circular A-123, Management's Responsibility for Internal Control Appendix A, Internal Control over Financial Reporting, using the DoD Risk Assessment and Internal Control Assessment forms. The Appendix A forms are accessible on the DoD Comptroller's public web site, under Financial Management Topics/Federal Managers' Financial Integrity Act/FY 2007 Guidance for the Preparation of the Statement of Assurance.

Transactions are particularly vulnerable to risk when they pass from one swim-lane to another, either manually or electronically. They are more vulnerable if they are complex, high in volume, and significantly impact financial reports. Table 4 of Part II, page 24 provides a guide to assessing risk. As transactions pass from one swim-lane to another, management implicitly represents that the five assertions shown below are embodied in the financial transaction. A risk assessment determines where risk exists that might circumvent one or more of these assertions. Management must identify what significant risks exist with regard to its assertions. An excellent way to recognize a risk is to find where the process crosses different areas of responsibility or to identify where responsibilities are being passed from one place or person to another. Then consider what control is in place to mitigate the risk. The five financial assertions are:

- **Completeness:** Management represents that all transactions and accounts that should be presented in the financial reports are included.
- **Obligations and Rights:** Management represents that recorded assets are the rights (ownership or preponderant responsibility for reporting) of the entity and that recorded liabilities are the obligations of the entity at a given date.
- **Valuation or Allocation (Accuracy):** Management represents that assets, liabilities, revenues, and expenses have been included in the financial reports at appropriate amounts.
- **Existence or Occurrence:** Management represents that all financial components of the transaction actually existed at a given date or occurred during the accounting period.
- **Reporting: Presentation and Disclosure:** Management represents that the financial reports are properly classified, described, and disclosed.

In addition, when data is passed through an IT medium, four objectives are to be assumed to have effective controls within the application and related manual procedures. They are:

- **Completeness:** Are all key fields complete? Is the transaction completely processed?
- **Accuracy:** Is the output accurate? Does it reflect what was input?
- **Validity:** Is the data valid?
- **Restricted Access:** Is the data, program administration, and programming free from unauthorized access or manipulation?

These IT objectives must also be assessed for inherent risk.

Perform the risk assessment on the DoD Risk Assessment Form using the business process flowcharts of key processes to identify risk. Indicate when high risk areas exist by inserting a control point indicator in your process flowcharts as shown in the sample flowchart on page 44 in Part II of this annual guidance.



The Risk Assessment deliverable consists of the DoD Risk Assessment form, completed in Columns 1 through 10, for each process reported in the December 18 flowchart deliverable and the organization's FISMA Report **if** the organization owns any financial or mixed systems which impact the component's financial statement.

The following may be helpful in performing a risk assessment and determining if a risk factor is significant:

1. Is the risk defined adequately enough to explain what could go wrong - from a financial reporting perspective?
2. Have all financial risks been identified? (Note: Think about what could go wrong for each shape and focus on the financial impact.)
3. Does the risk identified relate to a financial or IT assertion?
4. Does every risk have its own number?
5. Does every risk statement contain a cause and effect?
6. Have risks been documented where the risk exists?
7. Would a misstatement or error indicate major systemic problems?
8. Was a misstatement or error previously reported in an internal or external audit/review?
9. Have there been any changes to processes that have not been reviewed?

Table 4 gives examples of high risk and low risk conditions. A sample risk assessment (**Deliverable B**) is shown in Section B.

**Table 4**

<b>Risk Assessment Worksheet</b>					
	<b>Event</b>				
<b>Examples</b>	<b>Order Acceptance</b>	<b>Receiving</b>	<b>Vendor Maintenance</b>	<b>Invoice Processing</b>	<b>Performing Services (filling customer orders)</b>
<b>High Risk</b>					
Complex programs/operations					
Complex transactions					
Use of accounting estimates					
Extensive manual processes / applications					
Decentralized accounting / reporting functions					
Changes in operating environment					
Significant personnel changes					
New / revamped information systems					
New technology					
Amended laws / regulations					
New accounting standards					
<b>Low Risk</b>					
Simple operations / accounting transactions					
Low transaction volume					
Centralized accounting functions					
Static operating environment					
<b>Management Risk Assessment</b>					

## Identifying Internal Controls

All managers are responsible for establishing internal controls in their areas of responsibility and continuously assessing the effectiveness of the internal controls to meet intended control objectives and management assertions. The DoD Components are expected to conduct, at a minimum, annual independent assessments that may identify financial reporting internal control weaknesses. Continuous monitoring, supplemented by periodic assessments, should be documented in enough detail to support management's assertion as to the effectiveness of internal controls.

Risk may be related to the control itself (lack thereof, poor design, ineffectiveness), or it may be related to the nature of the process – inherently risky (one person office, carrying cash). Risk may be high due to the combination of the two types of risk. Control risk is defined below:

- **Control Risk:** The risk that a material misstatement could occur in an assertion and will not be prevented or detected and corrected on a timely basis by the entity's internal control. The use of professional judgment is essential in assessing control risk.
  - Low Control Risk: The preparer believes that controls WILL prevent or detect any aggregate misstatements that could occur in the assertion in excess of design materiality (low risk of misstatement).
  - High Control Risk: The preparer believes that controls will PROBABLY NOT prevent or detect any aggregate misstatements that could occur in the assertion in excess of design materiality (high risk of misstatement).

After documenting the business process and identifying and assessing inherent risk the component managers should identify the key controls within the major transaction cycle. Address only controls related to "High" Inherent Risk. Controls are the specific policies, procedures, and activities that are established to manage or mitigate risks identified in the risk assessment process. Key controls are those controls designed to meet the control objectives and cover management's financial assertions. In other words, they are the controls that management relies upon to prevent and detect material errors and misstatements.

As part of the control identification process, management may identify redundant controls or controls that are ineffective and eliminate them. When identifying controls, the component should consider the presence of multiple controls within the same transaction cycle. Typically, a single control within a major transaction cycle would not be considered sufficient. Conversely, there may be transaction cycles that have more than one control to detect the same problem.

Once the Inherent Risk Analysis for a business process area has been completed, identify the internal controls (IC) in place to mitigate inherent risks, assess the control and determine a preliminary control test method. IC test methods include interviews, observation, inspection, re-performance and, in the case of external service providers, obtaining assurances from them. Once internal controls have been identified, complete the Risk Analysis Form, Columns 11 through 13 on page 48 of Part II.

The following questions may be useful in identifying internal control:

1. Have all financial controls been identified? – (How do we prevent what could go wrong?)

2. Does every control link to at least one risk?
3. Are there any risks/controls that apply to the whole process?
4. Does the control explain who performs, when in the process/cycle, and how the control executed?
5. If a management review/monitoring control, does the control detail:
  - a. How often are reports/results reviewed?
  - b. What is the purpose of the review? (control objective)
  - c. Who performs?
  - d. Follow-up procedures for discrepancies/unusual variances?
6. If a segregation of duties control, does the control detail:
  - a. Which responsibilities are segregated?
  - b. How are duties segregated? (view / read-only)
  - c. Does an organization or department chart exist, and where is it located?
7. If an approval or authorization control, does the control detail:
  - a. Whether it is manually documented or system driven?
  - b. Who approves (what level of management?)
  - c. Existence of an established level of authorization?
8. If a reconciliation control, does the control detail:
  - a. Who prepares and performs the reconciliation? (control objective)
  - b. What is the purpose of the reconciliation?
  - c. Who reviews the reconciliation?
  - d. What reports are used and which systems generate the reports used?
  - e. How are differences investigated / resolved?
9. If a document control, does the control detail that:
  - a. Documents are pre-numbered and system generated (e.g., MIPRs, customer orders, invoices, etc)
  - b. Documents are safeguarded (e.g., physical controls over checks, contracts, manual journal entry logs, receiving reports, etc.)?
10. If a physical asset control, does the control detail:
  - a. How is access to the asset and related record keeping appropriately restricted?
  - b. Is it reviewed periodically?
  - c. What procedures ensure the accuracy of the related record keeping (activity logs)?
11. If a system based control, does the control detail:
  - a. All key fields for data entry must contain valid information (e.g., current date, established dollar range) in order for a record to be accepted.
  - b. Information is validated against a master table (e.g., customer number, product number, vendor number, PO number, stock number).
  - c. Master tables are reviewed and updated regularly to ensure accuracy and table data is safeguarded.
  - d. Duplicate postings/entries are not accepted.
  - e. Reporting period-end cut-off dates are enforced by the system.
  - f. System-based control overrides must be authorized.
12. Is the control frequency documented e.g., quarterly, monthly, weekly, daily, multiple times daily? (Control universe equals how many times control is performed/year)
13. Does the control description adequately explain how it mitigates the risk?
14. Is the control owner listed?

15. Are position titles (not names) used?
16. Is the control technique (Systemic, Manual) listed? Is the control technique listed accurate?
17. Has the preparer assessed the design effectiveness?
18. Has the preparer documented any deficiencies (Control gaps) in the design effectiveness?
19. Have controls been documented where they occur? Note: controls that occur outside of the process (e.g., senior management operational review) should be documented.
20. Would a control weakness result in a conflict of interest?

Examples of controls:

- Entity-wide security program, planning and management
- Top-level reviews of actual performance
- Reviews by management at the functional or actual level
- Controls over information processing
- Physical controls over vulnerable assets
- Segregation of duties
- Access restrictions to and accountability for resources and records
- Appropriate documentation of transactions transfers and internal control
- Password controls
- Program change requests are authorized
- Program version controls exist
- Training
- Annual inventory count
- Reconciliation to financial/accounting reports

Submit the list of internal controls and preliminary assessments and test methods to the ICOFR Project Manager by March 20, 2007. The March 20 deliverable consists of Risk Assessment forms with Columns 11 - 13 completed. (See page 48 of Part II of this annual guidance).

Address only identified controls that are **key** controls. These controls will be determined to be either effective or not effective, and subsequently, either at Low or High risk. Low risk **key** controls are those controls management believes are designed well and operating effectively and shall be tested. The results of the test will determine how management will report the effectiveness of its controls.

## Assessing Internal Controls

The Senior Assessment Team will ensure that corresponding control analyses are performed on the required key controls identified to mitigate the components high inherent risks shown on the Risk Analysis form.

When assessing internal controls, both design and application controls need to be assessed. Using the interactive DoD Control Analysis form which will carry forward from the DoD Risk Assessment form the identified risk and associated internal control in place describe the design of the control and perform a preliminary assessment on the design. (Does the design of the control accomplish the objectives of the control?) Then, perform a preliminary assessment on the application or operation of the control. (Is the control performed as it is designed to be applied?) Once management has

performed its preliminary assessment, the next step is to prepare test plans for those controls determined to be of low risk – that is, believed to be working as intended.

Only perform control tests on those controls which have been assessed to be “Low” Control Risk. For those controls identified as high risk or weak, develop corrective action plans to correct the weaknesses and enter the plans into the DoD FIAR web-based tool if the weaknesses are determined to be material. (See Develop Corrective Actions for further guidance.)

## **Preparing Test Plans**

If a Control Risk is determined to be “High,” there is no need to test the control. The reason for not testing the controls labeled “High” is that those controls have not been implemented or are not effective in either their design or operation. Once a control risk is assessed as “High,” corrective action plans are required to mitigate the risk.

For controls believed to be effective, they must be designed well and operate as designed. This requires testing of the design and operation of the key controls that were identified in the key process documentation and a determination of whether the control is operating effectively, partially effectively, or not effectively. Document all test design decisions. The testing should address both manual and IT (automated) controls. Automated controls considered key controls must be tested.

The goal of testing internal controls is to validate that they are functioning effectively and address the relevant control objectives and assertions. The purpose of the test plan is to document planned procedures to provide evidence of the operating effectiveness of each control and to identify lapses in implementations of these controls. Low risk key controls must be tested to verify the effectiveness of the controls identified in the Risk Analysis.

In developing the test plan, key items to consider include the objectives of the test (including what constitutes a deviation, or lapse, in a control process), the population, and method of selecting a sample, sample size, and the organization’s tolerance rate. These key items are further explained below:

**Objectives of the test** – The objectives of the specific control test should be clearly identified, and management should plan to evaluate operating effectiveness in terms of the rate of deviations from prescribed controls. This involves defining the specific control to be tested and the deviation conditions. The control deviation should be defined in terms of control activities not followed. For example, you may define a deviation in cash disbursements as “invoice not approved and initialed by authorized individual.”

**Population** – In defining the population, identify the whole set of items on which a conclusion needs to be reached and from which the sample will be drawn. This includes identifying how many times the control is performed within a given time (e.g., 4 times a year or 210 times a day) and as well as the number of sites at which the control is performed. This also includes determining the source document, documents or process to be tested, and defining the period covered by the test. When multiple locations are involved, consider all or several locations as one population for sampling if the controls at each location are

components of one overall control system. Before combining locations into one population, consider such factors as the extent of uniformity of the controls and their applications at each location, whether significant changes can be made to the controls or their application at the local level, the amount and nature of centralized oversight or control over local operations, and whether there could be a need for separate conclusions for each location. If the locations should be separate populations, select separate samples at each location and evaluate the results separately.

**Method of selection** – Samples selected should be representative of the population. As such, they should be selected at random without regard to transaction dollar amount or other special characteristics. Valid statistical sampling methodologies are not required. Software may be used to make random selections but is not necessary.

**Sample size** – Due to time and resource constraints, it would be impractical to test every item for each control. Sampling should be used to limit the number of transactions and other items tested, yet ensure the testing is adequate for the conclusions to be drawn. For Appendix A, the selection of sample size is based on the professional judgment and expert knowledge of the reviewer.

Attribute sampling, which is typically used when testing controls, includes selecting a sample of transactions from the total population and verifying the presence or absence of certain qualities. The result of each test is mutually exclusive (i.e., the control passes or fails the test.)

The items tested should support the preliminary assessment of control risk as low and thus test effectiveness of these controls. The sample size should be representative of the population in order to properly support the control assessment. Management should consider the frequency and complexity of the transaction type when determining sample size. Below is a required guideline for determining an adequate sample size:

Transaction Occurrence	Sample Size
Annually	1
Quarterly	2
Monthly	3
Weekly	10
Daily	30
Recurring	45

Note that the above table only provides guidance in relation to sample size and that management should use judgment and consider additional factors, such as the significance of the control and whether the control is manual or automated, when developing sample size. Management should also use judgment when designing procedures to ensure that specific control objectives and assertions are sufficiently supported by the internal control.

In many cases, a sample set of transactions can test multiple controls. This reduces the need for separate samples and provides for an improved understanding of how the controls interact. For example, Military Interdepartmental Purchase Request (MIPR) acceptance controls can be

tested using a sample of acceptance documents to determine that orders were properly reviewed by operations for resource availability and accepted by an authorized official.

**Tolerance Rate** – Before testing an internal control, management must determine the number of deviations, or lapses in control, it considers acceptable for a control. Management must address each control individually and establish what an acceptable tolerance rate will be for each control. Document the tolerance rate before testing and include it in the test plan.

Using the DoD Test Plan Form, management must define a testing procedure for each key control. The following are basic test methods and would be considered acceptable tests (Assurance from an external source is also acceptable):

- **Interview/Inquiry** – Asking what controls are in place and functioning or how an estimation algorithm has been developed;
- **Inspection** – Looking at evidence of a given control procedure, such as the signature of a reviewing official, initials of reviewers on reconciliation documents, and authorizations on acquisition, payment, or payroll documents;
- **Observation** – Watching actual controls in operation by observing processes in action such as a physical inventory or a reconciliation procedure; and
- **Re-performing** – Conducting a given control procedure more than once such as testing that a feeder system is providing accurate information to a financial system, recalculating an estimate, or checking to see that what is input into a system creates accurate output.
- **External Assurance** is also acceptable (Used as a place holder for internal controls which are performed by external sources such as DFAS).

The management process owner should recommend the extent of testing and document the testing approach. Factors that should be considered when determining the extent of testing or sample sizes are:

- Changes in the volume or nature of transactions;
- Changes in the design of controls;
- The degree to which the control relies on the effectiveness of other controls (e.g., the control environment or IT general controls);
- Changes in key personnel who perform the control or monitor its performance;
- The degree to which the control relies on performance by an individual rather than automation; and the complexity of the control.

There could be instances where there is more than one control to accomplish a particular control objective or where similar controls are employed across multiple systems (e.g., computer access controls). If this is the case, **for components which have achieved an “unqualified audit opinion,”** complementary controls or systems may be tested on a three year rotational basis, provided that, for those controls or systems not tested:

- There are **no** known weaknesses in the function of control;
- The controls have been tested within the last three years;



- There have been **no** changes in the design or operation of the control since it was last tested; and
- The system is not individually significant to the financial report.

For fully automated controls (including automated general, application, and security controls), **for components which have achieved an “unqualified audit opinion,”** not all controls must be tested each year, provided that for those controls not tested:

- The control is fully automated;
- Management has verified that adequate change controls exist over the automated control;
- No changes in the design or operation of the control have occurred since the control was last tested;
- There are no known significant weaknesses of the control; and
- The control has been tested in the past three years.

Such rotational testing must be disclosed in the ICOFR SOA.

Use the DoD Test Plan Form, available on the Comptroller's public web site, to complete test plans (see Sample Test Plan Section for examples):

<b>Entity</b>	Component or Other Defense Organization
<b>Preparer</b>	Name of person who is completing the test plan
<b>Acct Line</b>	Implementation area or business cycle
<b>Control #</b>	Identification number which is associated with the key control and should be identified in the process flowchart and narrative
<b>Risk</b>	Identify the risk that is associated with the control.
<b>Internal Control Currently in Place</b>	Identify the control that is currently in place if one exists. Control should be as shown on the Control Analysis Form. Note design and operation of control.
<b>Control Type</b>	Identify whether the control is <b>Manual</b> (Performed by individual, e.g. manual reconciliation, authorizing signature, etc.), <b>Automated</b> (Inherent to a system, e.g. edits, check, access authorization).
<b>Control Frequency</b>	The frequency or how often the control is performed (e.g. Continuous, Daily, Weekly, Bi-weekly, Monthly, Quarterly, Annually)
<b>Testing Period</b>	The timeframe when the test samples are being reviewed (1 year's worth, 1 week's worth, 1 day's worth/ 4 <sup>th</sup> work day, 2 <sup>nd</sup> quarter). Samples should be current and taken from the most recent reporting period.
<b>Test Method</b>	Identify the basic control test that is performed on the key control. The four basic types of tests include <b>Inquiry/Interview</b> (e.g. do you reconcile your activity or do you review a certain report each month; do you have someone calculating an estimate for you), <b>Inspection</b> (e.g. looking for signatures of a reviewing official or reviewing past reconciliations), <b>Observation</b> (e.g. observing a physical inventory or watching a reconciliation occur), and <b>Re-performing</b> a given control procedure (e.g. recalculating an estimate or re-performing a reconciliation). <b>External Assurance</b> is also acceptable (Used as a place holder for internal controls which are performed by external sources such as DFAS).
<b>Documentation Location</b>	If applicable to the testing, cite the location of the documents to be sampled and the office responsible for maintaining the documentation.
<b>Population and Sample Size</b>	A population is any entire collection of transactions, payments, or things for a given period of time from which we may collect data. It is the entire group we are interested in, from which we wish to describe or draw conclusions. A sample is a group of units selected from a larger group (the population). By studying the sample it is hoped to draw valid conclusions about the larger group. The sample size is the number of items selected for review.
<b>Criteria for Effectiveness/ Tolerance Rate</b>	State the tolerance rate: How many exceptions are acceptable for the test to still be successful. Provide the decision basis for establishing your tolerance rate. The tolerance rate is the maximum rate of deviations from the prescribed control acceptable without altering the preliminary assessment of control effectiveness.
<b>Test Description</b>	Describe how the test plan will be performed, where it will be performed and who will be performing the testing.
<b>Test Strategy</b>	Describe how the test is intended to validate that the control effectively mitigates identified risk as designed and operated, meets its control objective, and provides sufficient evidence to support management's assertion of effectiveness.
<b>Test Results</b>	Describe the results of test work performed and how it affects preliminary control risk. How many samples passed/failed testing?

Once the test plan is developed, the criteria should be integrated into a testing document. The testing document tracks the test work performed to ensure all control objectives are tested for effectiveness for each sample selected and serves as a worksheet for the tester. Below is a summarized example of a real property testing worksheet that tests certain key controls:

	Date in Service	Property Description	Properly Authorized	Recorded in Proper Period	Properly Supported
1					
2					
3					

### Performing and Evaluating Tests

Components are required to test the operating effectiveness of the controls for key processes. Perform the tests using the test plan as prepared and report the results of the tests on the bottom of the test plan form. Tests must not be performed by those who perform the controls, but must be performed by an independent party, such as management from another office or internal review staff, who would not have a vested interest in test results' being positive.

Management must also identify and correct any deficiencies in ICOFR. A deficiency in operation of the control exists if a properly designed control is not working as intended. If testing reveals that a control is either not being employed or is malfunctioning, management should look for a secondary or mitigating control that would detect problems somewhere in the same process. Identifying such controls may enable the team to provide assurance on ICOFR despite the failed primary control. The secondary or mitigating control would need to be tested for effectiveness before such assurance could be made. The lack of control should be documented.

Management must evaluate the results of control testing. As a result of the evaluation of the design and operating effectiveness of the controls, management will conclude whether:

- There are control gaps;
- The design of the controls is effective or not effective; and/or
- The operating effectiveness of the controls is effective, partially effective or not effective.

Management should consider whether an ineffective control would allow a material error or reportable condition to occur and go undetected. Internal control over financial reporting is subject to cost-benefit constraints, and no system is designed to provide absolute assurance that errors or misstatements will not occur. Results will identify when a deficiency exists; judgment needs to be applied to decide whether the consequences of ineffective controls are significant enough to allow material errors or misstatement to occur and not be detected.

If design or operating effectiveness deficiencies are noted, the SAT should discuss the results for each documented error with management to determine the validity of the error, and whether there are compensating controls to mitigate the problem. This may result in management's expanding the sample size to determine if the error rate is accurate. If the additional testing continues to prove the

control is not functioning effectively, and there are no mitigating or compensating controls to prevent or detect a material error or reportable condition, this control deficiency should be documented.

When testing is complete, use the DoD Control Analysis Sheet for reassessing control risk and reporting results of testing. Post the test results in the last column of the Control Analysis form and reassess the control. An example of an Internal Control Analysis (**Deliverable G**) is shown in Section C.

The results of the test work performed will be used to either support the preliminary assessment of control risk or support a revision of this assessment. Determining factors will be the number of deviations or exceptions that were noted during test work. The guidance below may be used to confirm or revise preliminary assessment of control risk:

**Low control risk** – Test work resulting in no deviations confirms the preliminary control assessment and controls are deemed effective. If deviations are noted that do not exceed the tolerance rate, then control risk should continue to be assessed as low and deviations should be addressed by management. If the occurrence of deviations exceeds the tolerance rate, then control risk should be reassessed as high and controls are deemed ineffective.

**High control risk** – If deviations are noted that exceed the tolerance rate, then control risk should be reassessed as high and controls deemed ineffective. High risk controls require a corrective action plan.

Managers should identify deficiencies in internal controls. A **control deficiency** or combination of control deficiencies that, in management's judgment, represents significant deficiencies in the design or operation of internal control that could result in a financial reporting misstatement is a **reportable condition** and will be internally tracked. A reportable condition that the DoD Component Head determines to be significant enough to be reported outside the Component will be considered a **material weakness** and included in the Statement of Assurance on Internal Control over Financial Reporting. The designation of a material weakness is a management judgment that should be based on relative risk and control test results. The bottom line is that the weakness is considered material if the Head (or principal deputy) of the Component determines to include the weakness in the Statement of Assurance on Internal Control over Financial Reporting submitted to the Secretary of Defense.

While evaluating the testing results, the SAT and management have another opportunity to evaluate the efficiency of operations, the performance of controls, and the individuals who perform them. Redundant or unnecessary procedures performed in the execution of controls by individuals may be identified and eliminated. Review may also reveal that poor execution of an otherwise properly designed control may have resulted in a deficiency. Component management will then want to take action to address these performance issues.

The SAT should discuss the potential impact of any control gaps or deficiencies on financial reporting with the process owners. The magnitude or significance of the consequence of the deficiency will determine the weakness category. Each deficiency must be categorized according to its impact on financial reporting assertions. Deficiencies should be categorized as an internal control deficiency, a reportable condition, or a material weakness. The SAT has a responsibility to report all material weaknesses in ICOFR in the annual statement of assurance.

An **internal control deficiency** exists when the design or operation of a control does not allow management or its employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

A **reportable condition** is an internal control deficiency, or combination of internal control deficiencies, that adversely affect the ability to initiate, authorize, record, process, or report external financial data reliably in accordance with generally accepted accounting principles, to the point there is a more than a remote likelihood that a misstatement of financial statements, or other significant financial reports, that is more than inconsequential, will not be prevented or detected.

The term “remote”<sup>2</sup> is defined as the slight chance of the future event(s) occurring. A misstatement is inconsequential if a reasonable person would conclude, after considering the possibility of further undetected misstatements, that the misstatement, either individually or when combined with other misstatements, would clearly be immaterial to financial reports<sup>3</sup>. If a reasonable person could not reach such a conclusion regarding a particular misstatement, that misstatement would be more than inconsequential.

A **material weakness** is a reportable condition, or combination of reportable conditions, resulting in more than a remote likelihood that a material misstatement of the financial statements or other significant financial reports will not be prevented or detected.

Control deficiencies should be remedied as they are identified, if at all possible. Although some corrective actions will be long term in nature, prompt remediation of control deficiencies will:

- Improve the effectiveness of the controls in the current fiscal year; and
- Allow the assurance statement to be prepared without including control deficiencies that have been remedied prior to June 30, 2007 or at least reporting that they have been remedied after June 30, 2007 but prior to September 30, 2007.

The completed Control Analysis Sheet is due on June 30, 2007 in hard and soft copy and requires a transmittal letter signed by the component’s Senior Assessment Team chair.

## **Weakness Dependencies**

At any time during a component’s process analyses, a reporting component may identify a weakness in its reporting process over which it has no control to correct because that part of the process belongs to another (a secondary) component. When this weakness is discovered, the reporting (primary) component should advise the secondary component of the situation and try to resolve the weakness. If, however, the primary component determines the weakness to materially impact its financial reports, and will be reported as a material weakness in its ICOFR SOA, the primary component should report the dependency relationship in the FIAR web-based tool Collaboration site.

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<sup>2</sup> Statement of Federal Financial Accounting Standard 5, *Accounting for Liabilities of the Federal Government*

<sup>3</sup> Public Company Accounting Oversight Board Auditing Standard 2

The Collaboration Site will be available for reporting components to enter weaknesses which must be corrected by other components from October 1, 2006 until March 20, 2007. The site requires the reporting component to:

- Identify itself, the preparer of the report, and contact information;
- State the control weakness in specific and detailed terms;
- Explain how the weakness materially affects its financial reports; and
- Identify who own the weakness process (the secondary component).

Upon approval by the ICOFR program manager, the program manager will notify the secondary component of the reported weakness and inform the secondary component that it has until June 1, 2007 to provide to the reporting component a satisfactory corrective action plan to remedy the weakness. The plan must be entered in the secondary component's financial improvement plan in the FIAR tool, complete with steps and target dates for completion so that the reporting component can copy the plan and paste it into its own corrective action plan to be included in its ICOFR SOA.

### **Preparing Corrective Action Plans**

The assessments of internal controls within the financial reporting process may disclose weaknesses in internal control. To correct a deficiency, the SAT together with Management should create a corrective action plan. A corrective action plan will most likely consist of revising or enhancing an already existing control, or implementing a new control. These enhanced or new controls should be tested over a period of time that is sufficient for management to determine that the design and operation of the controls are effective as of June 30, 2007. If the enhanced or new control cannot be tested by these dates or there is insufficient time to determine if the controls are actually working, the testing should not be performed until the following fiscal year, since there would be no benefit for the current fiscal year.

The assessment process includes developing plans and schedules to correct identified material weaknesses. Corrective Action Plans for material weaknesses will be entered into the DoD FIAR web-based, financial improvement tool in the component's financial improvement plan (FIP). Components also have the option to enter corrective action plans for their reportable conditions in the tool for monitoring and management purposes. These corrective action plans will become part of each component's Discovery and Correction Phase of its plan for achieving and/or sustaining a favorable audit opinion of its financial statements. The effect of entering corrective action plans is that the component will not only have a more robust plan for financial improvement, but it will also see where improvements are being made at all levels of the component's organization.

Corrective Action Plans should address the resolution of a specific identified weakness and include the steps and associated timelines required to complete the corrective action. When developing and entering a corrective action plan to resolve a material weakness which will be reported in the component's ICOFR SOA:

- State the as-is weakness conditions on first line of the plan, and list tasks to correct weaknesses on subsequent lines in the FIP. The weakness should be briefly detailed and

clearly stated. All tasks/lines within one plan to correct a weakness must have an A-123 identifier.

- To identify corrective action plans which will be reported in the component's ICOFR SOA, use the "A-123" data field in the FIP template and select ICOFR from the drop-down menu.
- Recognize corrective action plans related to reportable conditions in "A-123" field by selecting "Reportable Condition." This will serve as notice that this corrective action will not be reported as a material weakness in the component's ICOFR SOA.
- Components entering corrective action plans which they will perform within their own processes to correct a material weakness in another component's process should enter the correction plan in its (the correcting component's) FIP. Enter the name of the component for whom the correction is being made in the "Resource Names" data field. These corrective actions must be in the web-based tool by June 1, 2007 so that the reporting component will have time to copy the plans to their FIPs. If the correcting component deems the weakness that it is correcting for another component to be sufficiently material to its operating processes that it will be reporting the weakness in its overall Annual FMFIA Statement of Assurance, the correcting component should identify the corrective action plan as "MIC" in the "A-123" data field. This will serve as notice that this corrective action plan will be reported by the component in its overall Annual FMFIA Statement of Assurance.

If system development and fielding is a component's solution to correcting a material weakness, the corrective action plan must include the following:

- A schedule for development and fielding to the point where the component believes the weakness will be corrective, and internal controls will be effective;
- Tasks within the schedule demonstrating attention to internal controls which address the five financial management assertions and the four system control assertions;
- Compliance with the Standard Financial Information Structure; and
- Compliance with the Department of Defense Business Enterprise Architecture.

A **systemic weakness** is a material weakness that is reported by more than one Component. Once reported, the same material or systemic weakness should never reappear as a new, re-titled weakness in future Statements of Assurance on Internal Control over Financial Reporting. Instead, the original weakness should reflect that it was completed. The new instance should retain the same name as the original weakness but show a new date identified. For example, consider a material or systemic weakness that a Component originally identifies in FY 2006 and corrected in FY 2007. Then in FY 2008, management assessments identify related problems and the component wants to report it as a new material weakness in FY 2008. The material weakness should retain the same title as the original, but the "Year Identified" date would now appear as FY 2008, not FY 2006.

Weaknesses previously reported in the FMFIA Overall Statement of Assurance which appear to be financial in nature should not be automatically transferred to the Statement of Assurance on Internal Control over Financial Reporting. Only when a weakness has been discovered or confirmed as a result of the prescribed risk and internal control assessments and there is sufficient supporting documentation should the weakness be transferred from the Overall Statement of Assurance to the Statement of Assurance over Internal Control over Financial Reporting.

Weaknesses that slip year after year and do not meet the targeted correction dates reflect negatively on the Department's commitment to improve. Therefore, the Component's Senior Assessment Team should resolve material weaknesses as quickly as possible and ensure that the targeted correction dates are met.

Components must be careful in defining and setting the scope of the material weakness problem. For example, if the deficiency is due to inadequate controls for effectively implementing the entry of personnel data into Defense Civilian Personnel Data System (DCPDS) requirements, the reported weakness and milestones should address that problem. It is incorrect to define the problem in a broad category such as financial system noncompliance, and then include corrective actions that narrowly address the deficiency in the incorrect entry of data. In this case, the definition and specification of the weakness scope is too broad (i.e., implying an action greater than the Component intends or is able to correct).

Sometimes it is preferable to address several related problems in one weakness statement. However, Components should be cautious when defining a weakness. For example, in addition to the hypothetical weakness stated above, a Component might have concluded that there are other control problems related to payroll processes. Combining several problems and reporting one weakness under a broad statement that the Component will correct deficiencies in the Fund Balance with Treasury process may overstate the dimensions of the weakness. Confine the weakness statement to the scope of the specific problem(s) addressed. Consolidation of like weaknesses into a single comprehensive weakness is encouraged only when appropriate conditions apply and when defined, specific actions will correct the deficiency. Avoid bundling a number of related weaknesses for the principal purpose of reducing the number of material weaknesses reported. Weaknesses defined too broadly are very difficult to resolve and usually result in repeatedly missed targeted correction dates. Weaknesses reasonably defined provide a means of accomplishing improvement and result in sustained support in an improvement process.

## **Summary**

### **Internal Control Assessments Steps:**

1. Identify and Chart Key Business Processes
2. Perform Inherent Risk Assessment on Business Processes
3. Identify and Assess Controls
4. Prepare Test Plans
5. Test Controls
6. Complete Internal Control Assessment Form
7. Prepare Corrective Action Plans
8. Report Internal Control Effectiveness



## **PREPARING THE FMFIA OVER FINANCIAL REPORTING STATEMENT OF ASSURANCE**

The statement will cover the one year period from 1 July – 30 June and be effective *as of June 30<sup>th</sup> of fiscal year (FY) 2007*. If a material weakness is expected to be corrected within the 4<sup>th</sup> Quarter (Qtr) of FY 2007 but all actions are not completed as of June 30<sup>th</sup>, the DoD Component Head should report the material weakness as still ongoing. Should an entity elect to contract for an audit opinion of its internal control over financial reporting, the effective date may be adjusted to coincide with the audit opinion.

Statements of Assurance will follow guidance described in pages 3 through 11 of Part II. Plans and schedules to correct material weaknesses shall be reported using the same format for the material weaknesses status reports as provided in the entities' Annual FMFIA Statement of Assurance. Reported material weaknesses must be supported by documentation resulting from internal control assessments of "High Risk" or from internal control testing.

## Section A

An example of a narrative and its process flowchart of the Accounts Receivable / Reimbursable Process for the fictitious Defense Aircraft Agency (DAA) are given beginning with the narrative below.

### **Narrative, Flowcharting, and Organizational Chart Example (Deliverable A):**

#### *Defense Aircraft Agency Reimbursable Narrative*

#### **Narrative on *Accounts Receivable / Reimbursable Process***

##### Overview

Accounts Receivable represents amounts owed to the Component of DoD from others such as individuals, organizations, public entities or other government organizations. Most receivables result from the performance of services, the delivery of goods, court-ordered assessments or claims against contractors for inadequate or lack of performance. Accounts receivable include both intragovernmental (due from other federal agencies and DoD entities) and accounts receivable due from the public.

One process which materially impacts the DAA's Accounts Receivable balance is the reimbursable order process. Reimbursable orders or authorizations are written agreements between two federal organizations, or one federal organization and a private party. These written agreements can be a Military Interdepartmental Purchase Request (MIPR), Memorandum of Understanding (MOU), Memorandum of Agreement (MOA), or other written agreement where goods or services are provided in exchange for payment.

Performing organizations such as the DAA, receive orders for services with an offer to pay a certain amount. The DAA, as seller, checks the level of remaining reimbursable authority to ensure the authorized limit is not exceeded, checks available resources to ensure order can be filled, and checks amount of MIPR funds to ensure there are sufficient funds to complete the order. Upon accepting the order, the MIPR becomes a funding document with obligation authority in the amount of the MIPR. The DAA establishes a new account code for each MIPR to capture costs accurately.

The DAA obligates the amount of the MIPR and uses the obligation to fund the services being performed for the buyer. If the order involves services which would incur employee accrued benefits costs, DAA reserves a portion of the buyer's funding to record liabilities and pay expenses incurred by an employer such as the employer portion of Federal Insurance Contributions Act (FICA) costs and retirement and other benefits. As work is performed, the seller records the work against the order. DFAS records the corresponding accruals, payables, receivables, revenues and disbursements against the order received. The accounting system automatically changes the unfilled customer orders to filled customer orders when the receivable is established. Periodic reconciliations are appropriately performed to deobligate unnecessary obligations or research for late undelivered orders.

Services performed are captured as intragovernmental and public costs against the order. The order is captured as revenue as the work is performed. MIPR Revenue is Intragovernmental Revenue. Upon receipt of the documentation showing that goods or services were provided and revenue was earned, a receivable is recorded at the detail transaction level which will generate a bill to submit to the requesting component.

Collection of the billed amount may be done through the Intra-Governmental Payment and Collection (IPAC) system or by check payment received by DFAS or the Defense Aircraft Agency and recorded in the disbursing system to account for the collection. A collection increased Fund Balance with Treasury and decreases Accounts Receivable on the Balance Sheet and Reimbursable and Unfilled Orders information on the Statement of Budgetary Resources.

The accounting system compiles the data and generates the Trial Balance based on United States Standard General Ledger (USSGL) data. Accounts which may be affected by the reimbursable order process are:

- 1010 Fund Balance With Treasury
- 1310 Accounts Receivable
- 1521 Inventory Purchased for Resale
- 1750 Equipment
- 1759 Accumulated Depreciation - Equipment

- 2110 Accounts Payable
- 2120 Disbursements in Transit
- 2160 Entitlement Benefits Due and Payable
- 2190 Other Accrued Liabilities
- 2210 Accrued Funded Payroll and Leave
- 2211 Withholdings Payable
- 2213 Employer Contributions and Payroll Taxes Payable
- 2215 Other Post-Employment Benefits Due and Payable
- 2310 Advances from Others
- 2610 Actuarial Pension Liability

- 3101 Unexpended Appropriations – Appropriations Received
- 3102 Unexpended Appropriations – Transfers In
- 3107 Unexpended Appropriations - Appropriations Used

- 4119 Other Appropriations Realized
- 4170 Transfers – Current-Year Authority
- 4210 Anticipated Reimbursements and Other Income
- 4221 Unfilled Customer Orders w/out Advance
- 4222 Unfilled Customer Orders with Advance
- 4251 Reimbursements and Other Income Earned - Receivable
- 4252 Reimbursements & Other Inc Earned – Collected
- 4450 Unapportioned Authority
- 4510 Apportionments
- 4590 Apportionments Unavailable – Anticipated Resources

4610 Allotments - Realized Resources  
4801 Undelivered Orders – Obligations, Unpaid  
4901 Delivered Orders – Obligations, Unpaid  
4902 Delivered Orders – Obligations, Paid

5100 Revenue from Goods Sold  
5200 Revenue from Services Provided  
5700 Expended Appropriations

6100 Operating Expenses/Program Costs  
6500 Cost of Goods Sold  
6710 Depreciation, Amortization & Depletion

Trial balance information is then passed to the DDRS/Audited Financial Statement module for the preparation of the DAA Audited Financial Statements. The financial statements and related statement lines affected by the reimbursable process are: FMS 2108 Year-End Closing Statement, Balance Sheet, and Consolidated Statement Of Net Cost, Consolidated Statement Of Changes In Net Position, Statement Of Budgetary Resources, and Consolidated Statement Of Financing. The DAA performs reconciliations when financial statements are produced to ensure the transactions were posted to the correct financial statement lines.

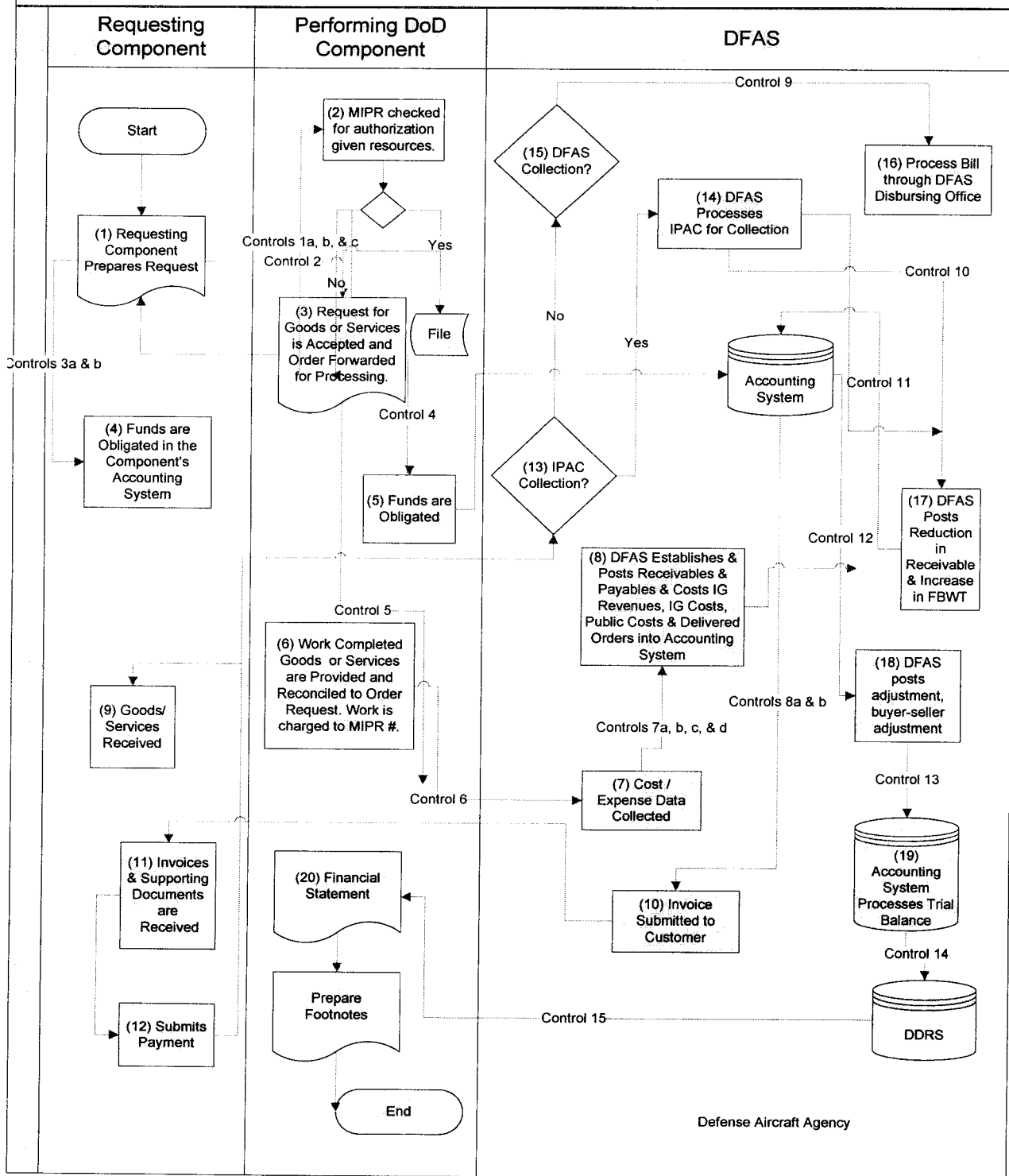
The following is a step by step description of the process (*each number corresponds to the identical number on the flowchart*):

1. DoD (Buyer) component prepares request for goods or services needed (MIPR, MOA) from DAA.
2. DAA (Seller) checks its reimbursable authorization balance, available resources and compares cost of order to amount offered.
3. DAA (Seller) accepts request and forwards the order for processing (MIPR, MOA) to personnel and operations, establishes a new account code for the order, advises DFAS and stores the documentation for offer (MIPR) and acceptance.
4. DoD (Buyer) obligates full amount of MIPR in its accounting system to fund seller's costs.
5. DAA (Seller) obligates funds in its accounting system to process orders.
6. DAA (Seller) provides goods or services to customer and charges costs to order request, coding all transactions against the order number code.
7. DFAS collects cost / expense data.
8. DFAS captures obligations, accruals, and payables, receivables, intergovernmental costs and revenues, filled and unfilled orders and disbursements.

9. DoD (Buyer) component received goods or services.
10. Monthly, based on captured financial data, DFAS invoices DoD (buyer) component based for work completed, providing supporting documents
11. DoD (Buyer) component receives invoice.
12. DoD (Buyer) component submits payment.
13. If payment is IPAC, then
14. DFAS processes IPAC collection.
15. If payment is a check collection (not through IPAC), then
16. DFAS posts collection to Seller's account, processing payment through DFAS disbursing office.
17. DFAS posts reductions in receivable in the accounting system resulting in increase in FBWT. The reimbursable process results in increases in Intragovernmental Revenue, increases in costs – either intragovernmental or public, depending on source of labor and parts purchased for the order, filled customer orders, and liquidated obligations.
18. DFAS performs elimination entries, adjustments and closing entries.
19. The DAA accounting system processes trial balances. Trail balances are transferred automatically to DDRS for financial statement computation.
20. Financial statements are produced from DDRS.
21. The DAA performs reconciliations on its financial statements to ensure balances are brought forward correctly and that the balance shown on financial statement lines are accurately presented and prepares footnotes to the statements.

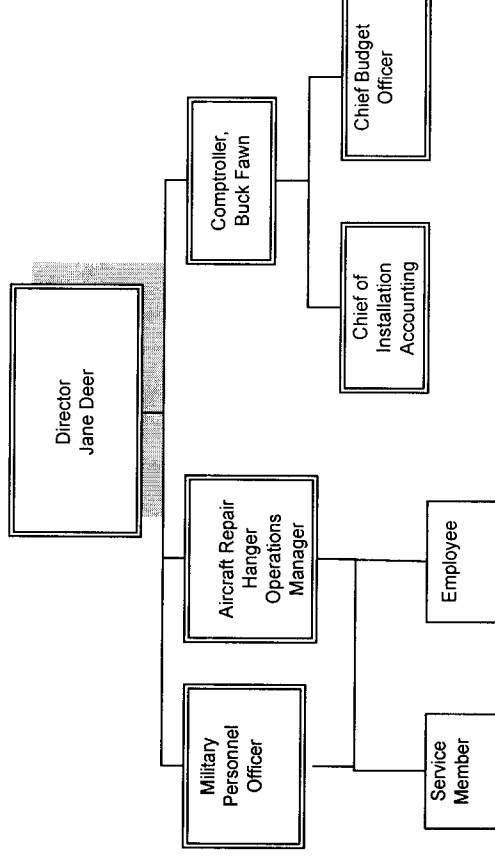
## ***Deliverable A***

## Flowchart – Accounts Receivable / Reimbursables



Deliverable A (continued):

## Defense Aircraft Agency Organization Chart



Note: The Disbursing Office and Component Accounting Office functions for Defense Aircraft Agency are owned by the Defense Finance and Accounting Service. Defense Aircraft Agency is a fictitious organization for this example.

## Section B

### Risk Analysis Example

The completed Risk Analysis form for the Defense Aircraft Agency is presented in Chart 1, page 48 of Part II below. The numbers contained in the cells of the sample Risk Analysis form shown in Section B correlate to the instructions below (and are used ONLY for identification purposes).

1. Choose from the available drop down list your particular entity. A full list of FSREs is available on Table 2.
2. Type in the name of the Risk Analysis Preparer. This should be the person who has responsibility for performing the risk analysis of this particular Implementation Area.
3. Type in the Risk Analysis Preparer's business telephone number.
4. Choose from the available drop down menu. Menu options are shown in Table 5 on pages 54-57 of Part II under Account/Line Item/Event.
5. Type in the Control Number from the Flowchart of the risk that will be assessed. (See Accounts Receivable / Reimbursable flowchart for Control Numbers.)

*For the DAA Accounts Receivable / example, the choice would be "Accounts Receivable."*

6. Choose from the available drop down menu, the particular Business Cycle or Accounting Application from Table 5 on pages 54-57 of Part II. If your business process is not in the drop down menu, choose "Other" and enter your process name. Each Implementation Area has its own specific set of Business Cycles/Events or Accounting Applications.

*In the Accounts Receivable / example, Intragovernmental Accounts Receivable / Reimbursable" is the Business Cycle or Accounting Application that will be assessed.*

7. Choose from the available drop down list, the Assertion that is being addressed. See Glossary for types of Assertions and definitions.

*The first assertion that will be assessed in the Accounts Receivable / Reimbursable example is "Rights / Obligation."*

8. Type in what the risk would be if a control did not exist.

*For example, the first risk of not having "Control 1" of the Accounts Receivable / Reimbursable would be that the customer order for services was not signed by an authorized official."*

9. Select from the available drop down list the level of Inherent Risk: 1) High, or 2) Low. See the Glossary for the definition of Inherent Risk.



*Based on preparer's judgment for the Accounts Receivable / Reimbursable example, if circumstances exist at the buyer's organization which might allow an order to be signed by an unauthorized person, the circumstances would not materially impact financial reporting of DAA. Therefore, Inherent Risk is judged to be "Low."*

*The second risk, that of exceeding Congressional reimbursable authority, could occur if DAA had not controls in place and could significantly impact financial management of the organization. Therefore, the inherent risk is determined to be "High."*

**Deliverable B**

**Chart 1**

Risk Analysis												
1 Entity (Drop Down Menu): DAA												
2 Preparer:												
3 Phone Number of the Preparer:												
4 Account Line: Accounts Receivable / Reimbursable												
5	6	7	8	9	10	11	12	13				
Control Number	Account/Line Item/Event	Business Cycle, Accounting Application	Assertion	Risk	Inherent Risk	Internal Control Currently in Place	Control Risk	Internal Control Test Method To Be Used				
1a	Accounts Receivable / Intragovernmental	Intragovernmental Accounts Receivable / Reimbursable	Rights / Obligation	MIPR offer is signed by unauthorized person.	Low	<b>No further action necessary</b>						
1b	Accounts Receivable / Intragovernmental	Intragovernmental Accounts Receivable / Reimbursable	Rights / Obligation	Congressional authority balance not checked, could exceed authorization.	High	MIPRs only accepted in managerial accounting office. Accepting official signs MIPR after checking.	Low	Inspection				
1c	Accounts Receivable / Intragovernmental	Intragovernmental Accounts Receivable / Reimbursable	Existence / Occurrence	Resources not available in current period to fill order.	High	MIPR sent to operations before acceptance. Operations officer signs as resources are available.	Low	Inspection				
2	Accounts Receivable / Intragovernmental	Intragovernmental Accounts Receivable / Reimbursable	Existence / Occurrence	Unverified orders are processed.	High	Acceptance reviewed for proper signature by individual entering order in accounting system. Roles are reviewed annually by proper officials to ensure valid authorization.	Low	Inspection				

Risk Analysis												
1 Entity (Drop Down Menu): DAA												
2 Preparer:												
3 Phone Number of the Preparer:												
4 Account Line: Accounts Receivable / Reimbursable												
5	6	7	8	9	10	11	12	13				
Control Number	Account/Line Item/Event	Business Cycle, Accounting Application	Assertion	Risk	Inherent Risk	Internal Control Currently in Place	Control Risk	Internal Control Test Method To Be Used				
3a	Accounts Receivable / Intragovernmental	Intra-governmental Accounts Receivable/ Reimbursable	Completeness	Buyer does not obligate MIPR and does not have funding to pay at completion.	High	Monthly reconciliation with customer ensures obligation is on customer's books.	Low	Inspection				
3b	Accounts Receivable / Intragovernmental	Intragovernmental Accounts Receivable / Reimbursable	Presentation	Unliquidated obligations had no payment activity against them for extended period. Project cost distributions did not reduce obligations.	High	Monthly reconciliation with customer ensures obligation is on customer's books.	Low	Inspection / Observation				
4	Accounts Receivable / Intragovernmental	Intra-governmental Accounts Receivable/ Reimbursable	Completeness	Seller does not obligate MIPR. Customer paid from mission funds.	High	None identified.	High	Corrective Action Plan				
5	Accounts Receivable / Intragovernmental	Intra-governmental Accounts Receivable/ Reimbursable	Completeness/ Valuation	All performance costs are not captured for project.	High	Reimbursable transactions required a resource code. Also, MIPR has a document reference number. Accounting system will not post without code. Reconcile with accounting reports.	Low	Re-performing				

Risk Analysis									
1 Entity (Drop Down Menu): DAA									
2 Preparer:									
3 Phone Number of the Preparer:									
4 Account Line: Accounts Receivable / Reimbursable									
5	6	7	8	9	10	11	12	13	
Control Number	Account/Line Item/Event	Business Cycle, Accounting Application	Assertion	Risk	Inherent Risk	Internal Control Currently in Place	Control Risk	Internal Control Test Method To Be Used	
6	Accounts Receivable / Intragovernmental	Intra-governmental Accounts Receivable/ Reimbursable	Existence/ Occurrence	MIPR authorization is exceeded.	High	Monthly reconciliation of the subsidiary records to the general ledger balances are accomplished and documented. Flag set in system to alert 85% execution.	Low	Inspection	
7a	Accounts Receivable / Intragovernmental	Intragovernmental Accounts Receivable / Reimbursable	Existence / Occurrence / Completeness	Incorrect Line of accounting is entered into the accounting system.	High	Reimbursable transactions required a resource code. Also, MIPR has a document reference number. Accounting system will not post without code. Reconcile with accounting reports.	Low	Inspection	
7b	Accounts Receivable / Intragovernmental	Intragovernmental Accounts Receivable / Reimbursable	Existence / Occurrence / Completeness	Goods or services provided are not charged to the correct accounts receivable.	High	Monthly reconciliation of the customer order records to the general ledger transactions are accomplished and documented	Low	Inspection / Re-performing	

Risk Analysis									
1 Entity (Drop Down Menu): DAA									
2 Preparer:									
3 Phone Number of the Preparer:									
4 Account Line: Accounts Receivable / Reimbursable									
5	6	7	8	9	10	11	12	13	
Control Number	Account/Line Item/Event	Business Cycle, Accounting Application	Assertion	Risk	Inherent Risk	Internal Control Currently in Place	Control Risk	Internal Control Test Method To Be Used	
7c	Accounts Receivable / Intragovernmental	Intragovernmental Accounts Receivable / Reimbursable	Existence / Occurrence / Completeness	Accounts receivable has not been established.	High	The accounting system recognizes costs charged to MIPR and creates a receivable equal to cost.	Low	Observation	
7d	Accounts Receivable / Intragovernmental	Intragovernmental Accounts Receivable / Reimbursable	Existence / Occurrence / Completeness	Complete customer orders are not posted to accounts receivable.	High	Report identifies changes in customer accounts and the need for reimbursable and Intragovernmental Bills. Monthly reconciliation with accounting reports.	Low	Inspection	
8a	Accounts Receivable / Intragovernmental	Intragovernmental Accounts Receivable / Reimbursable	Valuation / Allocation	Customer invoiced for incorrect amount of goods or services received.	High	Reconcile MOU, MIPR or Contract to invoice.	Low	Inspection	
8b	Accounts Receivable / Intragovernmental	Intragovernmental Accounts Receivable / Reimbursable	Valuation / Allocation	Customer is not invoiced for goods or services received.	High	Accounts reconciled. Accounting codes identify costs to customers. System generates bills monthly.	Low	Inspection	
9	Accounts Receivable / Intragovernmental	Intragovernmental Accounts Receivable - IPAC	Completeness	IPAC payment and DFAS disbursing office processed payments for receivable. (IPAC)	High	Duplicate payments identified through use of automated detection program.	Low	Re-performing	

Risk Analysis												
1 Entity (Drop Down Menu): DAA												
2 Preparer:												
3 Phone Number of the Preparer:												
4 Account Line: Accounts Receivable / Reimbursable												
5	6	7	8	9	10	11	12	13				
Control Number	Account/Line Item/Event	Business Cycle, Accounting Application	Assertion	Risk	Inherent Risk	Internal Control Currently in Place	Control Risk	Internal Control Test Method To Be Used				
10	Accounts Receivable / Intragovernmental	Intragovernmental Accounts Receivable / Reimbursable	Completeness	Reduction in receivable is not posted.	High	Accounting codes are established to apply payment to the A/R at the time the bill is generated and collected thru IPAC. Accountants reconcile and balance all IPAC transactions before transmitting bulk file to Treasury.	Low	Observation				
11	Accounts Receivable / Intragovernmental	Intragovernmental Accounts Receivable / Reimbursable	Rights / Obligation	Receivables are not posted to correct account.	High	The A/R is created based on the customer order that was entered at the time of acceptance. (If paper) The bill that established the A/R is mailed to the customer. The customer uses this bill as reference when issuing payment. Review of the open accounts receivable balances and suspense account. Communication with customer.	Low	Observation				

Risk Analysis												
1 Entity (Drop Down Menu): DAA												
2 Preparer:												
3 Phone Number of the Preparer:												
4 Account Line: Accounts Receivable / Reimbursable												
5	6	7	8	9	10	11	12	13				
Control Number	Account/Line Item/Event	Business Cycle, Accounting Application	Assertion	Risk	Inherent Risk	Internal Control Currently in Place	Control Risk	Internal Control Test Method To Be Used				
12	Accounts Receivable / Intragovernmental	Intragovernmental Accounts Receivable / Reimbursable	Existence / Occurrence / Completeness	Accounts receivable not recorded in current accounting cycle.	High	Accounting line identifies service to customer order are incurred and bills are generated monthly. Monthly reconciliation of the subsidiary records to the general ledger balances are accomplished and documented.	Low	Observation / Inspection				
13	Accounts Receivable / Intragovernmental	Intragovernmental Accounts Receivable / Reimbursable	Presentation	Transactions are not mapped to correct SGL account	High	Monthly reconciliation of Trail Balance.	Low	Observation				
14	Accounts Receivable / Intragovernmental	Intragovernmental Accounts Receivable / Reimbursable	Existence / Occurrence / Completeness	Accuracy risk.	Low							
15	Accounts Receivable / Intragovernmental	Intragovernmental Accounts Receivable / Reimbursable	Presentation	MIPR funding posted to incorrect financial statement line.	High	Reconciliation.	Low	Observation / Re-performing				

**Table 5**

**Drop Down List Selections for Column 7 of Chart 1**

<b>Implementation Area Assessed</b>	<b>Business Event/Cycle Accounting Application</b>
FBWT	(+) Appropriation Received (Unexpended)
	(+) Advances from Customers
	(+) Collections from Earnings
	(+) Purchase Returns
	(+) Receipt of Treasury Warrant
	(+) Sales / Revenues
	(-) Appropriation Rescissions
	(-) Payments of Payables
	(-) Civilian Payroll
	(-) Military Payroll
	(-) Payment of Military Retiree Funding
	(+/-) Cash Transfers
	(+/-) Other
Investments	(+) Accounts Receivable, Intragovernmental
	(+) Accounts Receivable, Public
	(+) Amortization of Discount
	(+) Appropriation Used
	(+) Interest Received
	(+) Purchase of Investment
	(+) Unliquidated Obligations
	(-) Amortization of Premium
	(-) Appropriation Unexpended
	(-) Sale of Investment
	(+/-) Transfer of Investment
	(+/-) Year-end Close-out
	(+/-) Other
Accounts Receivables (Intragovernmental)	(+) Intragovernmental Revenues / Sales
	(+) Public Costs
	(+) Duplicate Payments
	(+) Intragovernmental Costs
	(+) Filled Orders
	(+/-) Obligations
	(-) Collections
	(+) Cancelled year Receivables
	(+/-) Other
Accounts Receivable (Public)	(+) Revenues from Public
	(+) Filled Orders
	(+) Duplicate Payments
	(+) Public Costs
	(+) Filled Orders
	(-) Collections
	(-) Allowance for Loss on Accounts Receivable
	(+/-) Balances Brought Forward
	(+) Cancelled year Receivables
	(+/-) Other
Inventory	(-) Purchases
	(+) Purchase Returns
	(+) Undelivered Orders



<b>Table 5</b>	
<b>Drop Down List Selections for Column 7 of Chart 1</b>	
<b>Implementation Area Assessed</b>	<b>Business Event/Cycle Accounting Application</b>
	(+) Unliquidated Obligations
	(-) Appropriation Unexpended
	(+) Appropriation Used
	(+) Intragovernmental Revenues / Sales
	(+) Public Revenues /Sales
	(-) Purchased for Resale
	(+) Held in Reserve for Future Sale
	(-) Held for Repair
	(-) Excess, Obsolete, and Unserviceable
	(-) Raw Materials
	(-) Work-in-Process
	(-) Allowance
	(+/-) Finished Goods
	(+/-) Other
OM&S	(+) Receipt of Operating Materials & Supplies
	(+) Undelivered Orders
	(-) Consumption of Supplies
	(-) Unliquidated Obligations
	(-) Held for Use
	(-) Held in Reserve for Future Use
	(-) Excess, Obsolete, Disposed & Unserviceable
	(-) Held for Repair
	(-) Allowance
Real Property	(+/-) Other
	(+) Appropriation Used
	(+) Capital Lease
	(+) Contract for Construction
	(+) Leasehold Improvements
	(+) Operating Lease
	(+) Purchase of Real Property
	(+) Transfer In of Real Property
	(-) Capital Lease Amortization
	(-) Contract for Destruction
	(-) Construction in Progress (CIP) to Real Property
	(-) Depreciation
	(-) Destruction of Real Property
	(-) Operating Lease Amortization
	(-) Sale of Real Property
	(-) Transfer Out of Real Property
	(+/-) Other
	(+/-) Unliquidated Obligations
Military Equipment	(+) Appropriation Used
	(+) Contract for Construction (Obligation)
	(+) Military Equipment Found on Installation
	(+) Procurement
	(+) Purchase of Military Equipment
	(+) Transfer In of Military Equipment

<b>Table 5</b>	
<b>Drop Down List Selections for Column 7 of Chart 1</b>	
<b>Implementation Area Assessed</b>	<b>Business Event/Cycle Accounting Application</b>
	(+) Work in Progress (WIP) Military Equipment
	(+) WIP to Military Equipment
	(-) Appropriation Unexpended
	(-) Depreciation of Military Equipment
	(-) Disposal of Military Equipment
	(-) Lost Military Equipment
	(-) Sale of Military Equipment
	(-) Transfer Out of Military Equipment
	(+/-) Undelivered Orders
	(+/-) Unliquidated Obligations
	(+/-) Year-end Close-out
	(+/-) Other
Accounts Payable (Intragovernmental)	(+) Receipt of Goods / Services
	(+/-) Unliquidated Obligations / Liquidated Obligations
	(+) Accounts Payable From Canceled Appropriations
	(+/-) Other
Accounts Payable (Public)	(+) Receipt of Goods & Services
	(+) Undelivered Orders
	(-) Unliquidated Obligations
	(+) Accounts Payable From Canceled Appropriations
	(+) Contractor Withholds
	(+) Interest
	(+/-) Balance Brought Forward
	(+/-) Other
FECA Liabilities	(+) Appropriation Used
	(+) Receive Bill from Department of Labor
	(-) Appropriation Unexpended
	(-) Pay Bill from Department of Labor
	(+/-) Unliquidated Obligations
	(+/-) Other
Environmental Liabilities	(+) Mission Operations
	(-) Clean-up
	(-) Pay Bill
	(+/-) EPA Decisions
	(+/-) Other
Health Care	(+) Capturing Costs of Patient Care
	(+/-) Cost of Contracted Care
	(+/-) Funding for Health Care
	(+/-) Code Patient Care Correctly
	(+/-) 3 <sup>rd</sup> Party Insurance Billings and Revenue
	(+/-) Other
Appropriations Received	(+) Receive Appropriation
	(-) Rescind Appropriation
	(+/-) Other
	(+) Unexpended Appropriations – Cumulative

<b>Table 5</b>	
<b>Drop Down List Selections for Column 7 of Chart 1</b>	
<b>Implementation Area Assessed</b>	<b>Business Event/Cycle Accounting Application</b>
	(+) Unexpended Appropriations – Appropriations Received
	(+) Unexpended Appropriations – Transfers-In
	(-) Unexpended Appropriations – Transfers-Out
	(+) Unexpended Appropriations – Adjustments
	Unexpended Appropriations – Used
	(-) Unexpended Appropriations – Prior-Period Adjustments Due to Corrections of Errors
	(-) Unexpended Appropriations – Prior-Period Adjustments Due to Changes in Accounting Principles
	(+/-) Other

## Section C

### Internal Control Plans and Analysis Example

The numbers contained in the cells of the example Control Assessment correlate to the instructions below (and are used ONLY for identification purposes). If a column in the Control Analysis does not contain a number, data is being automatically brought over from its corresponding Risk Analysis form.

1. The **Control Test Objective** column states the objective or purpose of the control. The **key** controls [the preparer] has identified on the risk assessment form as reducing risk must be supported by tests of controls to make sure that the controls have been adequately designed and are operating effectively throughout all or most of the period reviewed, if the controls are believed to be designed and operating effectively. If the Control Risk was deemed to be “High,” then the control is determined not effective and no reliance should be placed upon it. In such a case, the control would not be tested because it is believed that the control objective is not being met (See Chart 2, Control 2, page 60 in Part II). Instead, DAA would develop a corrective action plan to remediate the weakness and render the control effective.

*Continuing with the Accounts Receivable / Reimbursable Example, the control test objective for the second risk of Control 1 would be: “To ensure reimbursable authority is not exceeded within DAA.”*

2. The preparer described the design of the control shown in the Internal Control column and how the control design was tested.

*The test for the control design would be “Review the design to determine if the objective has been met.”*

3. The preparer must decide if the design of the control is effective based upon the testing performed, choosing either “Yes” or “No” from the available drop down list.
4. A control maybe designed well, but not be effective because those who perform the control, do not perform it correctly. Therefore, the operation of the control must be tested if the design is determined to be effective.

*The person authorized to accept the MIPR must check DAA’s reimbursable balance prior to acceptance. The test for operation of the control would be, “To inspect MIPR documents and authority records to see if MIPR balance was subtracted from authority balance at acceptance.”*

5. The preparer must decide if the operation of the control is effective based upon the testing performed, choosing either “Yes” or “No” from the available drop down list.
6. The Control Risk Level can then be reexamined based on the results of the control tests. The materiality of the control will determine how much to raise the risk level if tests failed. For

example, if the original Risk Level was “Low” and then was tested to be ineffective for both the Design and Operation, the Control Risk Level would be elevated to “High.” But if the Control Risk Level was “Low” and both the Design and Operation of the control were effective, the Control Risk Level would stay classified as “Low.”

*In the Accounts Receivable / Reimbursable of the Defense Aircraft Agency example, Control 1b is determined to be effectively designed and operating. The Control Risk remains “Low.”*

7. Enter in Block 7 the results of the test which served as a basis for the risk rating. Type in the results of the test: of \_\_\_\_ number of samples tested, \_\_\_\_ failed or there were no exceptions.

*The preparer describes the test of eight sample inspections resulted in no exceptions.*

**Deliverable C:****Chart 2**

Control Assessment										
Accounts Receivable / Reimbursable										
Entity:										
Preparer:										
Account Line:	Reimbursable									
Business Cycle, Accounting +/- Application	Risk	Control Number	Internal Control Currently In Place	1 Control Test Objective	2 Description of Design Test	3 Was Control Design Effective?	4 Description of Control Operation Test	5 Was Control Operation Effective?	6 New Control Risk Level	7 Test Results
Intragovernmental Accounts Receivable / Reimbursable	MIPR is signed by authorized person.	1a								
Intragovernmental Accounts Receivable / Reimbursable	Congressional authority balance not checked, could exceed authorization.	1b	MIPRs only accepted in managerial accounting office. Accepting official signs MIPR after checking.	Ensure reimbursable authority is not exceeded	Review design against organization structure.	Yes	Examine MIPR acceptances and reimbursable balance spreadsheet to see if acceptances were promptly subtracted from balance.	Yes	Low	Sample of eight inspections showed no exceptions.
Intragovernmental Accounts Receivable / Reimbursable	Resources not available in current period to fill order.	1c	MIPR sent to operations before acceptance. Operations officer signs as resources are available.	Ensure DAA has resources available to complete request for services	Review design against organization structure.	Yes	Examine MIPR acceptance for operation officer signature ensuring resource availability.	Yes	Low	Sample of eight inspections showed no exceptions.
Intragovernmental Accounts Receivable / Reimbursable	Unverified orders are processed.	2	Acceptance reviewed for proper signature by individual entering order in accounting system. Roles are reviewed annually by proper officials to ensure valid authorization.	Ensure unverified orders are not processed	Review design against current organization structure.	Yes	Inspect MIPRs for reviewer's initials.	Yes	Low	Sample of eight inspections showed no exceptions.

Control Assessment										
Entity:	Accounts Receivable / Reimbursable									
Preparer:										
Account Line:	Reimbursable									
Business Cycle, Accounting +/- Application	Risk	Control Number	Internal Control Currently In Place	Control Test Objective	Description of Design Test	Was Control Design Effective?	Description of Control Operation Test	Was Control Operation Effective?	New Control Risk Level	Test Results
Intragovernmental Accounts Receivable / Reimbursable	Buyer does not obligate MIPR and does not have funding to pay at completion.	3a	Monthly reconciliation with customer ensures obligation is on customer's books.	Ensure DAA funding of order.	Ensure organization structure provides for customer reconciliation	Yes	Examine reconciliation documents for evidence of reconciliation: initials of the reviewer	No	High	Five of eight inspections showed no evidence of customer reconciliation occurring.
Intragovernmental Accounts Receivable / Reimbursable	Unliquidated obligations had no payment activity against them for extended period. Project cost distributions did not reduce obligations.	3b	Monthly reconciliation with customer ensures obligation is on customer's books.	Ensure project costs are captured and related remaining ULOs are reduced.	Ensure organization structure provides for customer reconciliation	Yes	Examine reconciliation documents for evidence of reconciliation: deobligations of unnecessary ULOs.	Yes	Low	Seven of eight inspections showed
Intragovernmental Accounts Receivable / Reimbursable	Seller does not obligate MIPR. Customer paid from mission funds.	4	No control identified.	Corrective action plan required.					High	
Intragovernmental Accounts Receivable / Reimbursable	All performance costs are not captured to project.	5	Reimbursable transactions required a resource code and reimbursable indicator. MIPR has a document reference number. Accounting system will not post without code.	To ensure costs are captured to MIPR	Examine coding capability and system access requirements.	Yes	Inspect accounting records and reimbursable work to ensure control is being performed.	Yes	Low	Seven of eight MIPRs were coded properly in the accounting system; work was being captured.

Control Assessment										
Accounts Receivable / Reimbursable										
Entity:										
Preparer:										
Account Line:										
Reimbursable										
Business Cycle, Accounting +/- Application	Risk	Control Number	Internal Control Currently In Place	1 Control Test Objective	2 Description of Design Test	3 Was Control Design Effective?	4 Description of Control Operation Test	5 Was Control Operation Effective?	6 New Control Risk Level	7 Test Results
Intragovernmental Accounts Receivable / Reimbursable	MIPR authorization is exceeded.	6	Monthly reconciliation of the subsidiary records to the general ledger balances are accomplished and documented.	Ensure subsidiary records reconcile to the general ledger balances monthly and are documented.	Check if existing control operate as designed so that subsidiary records are reconcilable to the general ledger balances monthly.	Yes	1) Observe how technician verifies that the amount to be obligated does not exceed the amount originally authorized in the MIPR/order. 2) Inspect to confirm that obligating document does not exceed balance of MIPR/order authority. 3) Inspect records to validate request for additional funding	Yes	Low (no change)	Testing resulted in zero deviations/errors; 30 of 30 sample items tested (100%) followed internal control procedures. Assessed preliminary control risk is properly supported and remains Low.
Intragovernmental Accounts Receivable / Reimbursable	Customer invoiced for incorrect amount of goods or services received.	8a	Reconcile MOU, MIPR or Contract to invoice.	Confirm MOU, MIPR or Contract reconcile to invoice.	Make sure all documents are available.	Yes	1. Obtain all supporting documentation for the billing. 2. Verify that adequate documentation is on file to support billing.	Yes	High	Test work resulted in 2 exceptions of 30 samples. Assessed preliminary control risk of low is not supported.
Intragovernmental Accounts Receivable - IPAC	Customer is not invoiced for goods or services received.	8b	Accounts reconciled. Accounting codes identify costs to customers. System generates bills monthly.	Make certain accounts reconcile, accounting codes identify costs to	Verify that system generates bills monthly.	Yes	A sample of three reconciliations will be chosen from the population by random selection or haphazardly, if	Yes	Low (no change)	Test work resulted in zero exceptions. All interviewed



Control Assessment										
Accounts Receivable / Reimbursable										
Entity:										
Preparer:										
Account Line:	Reimbursable									
Business Cycle, Accounting +/- Application	Risk	Control Number	Internal Control Currently In Place	1 Control Test Objective	2 Description of Design Test	3 Was Control Design Effective?	4 Description of Control Operation Test	5 Was Control Operation Effective?	6 New Control Risk Level	7 Test Results
				customers, and system generates bills monthly.			random selection is not possible. The test selection will be inspected for: 1) Supporting documentation, 3) Timely resolutions of differences and 4) Follow-up. Ensuring unresolved discrepancies do not accumulate.			personnel and reviewed documentation followed the expected internal control procedures. Assessed preliminary control risk of low is properly supported.
Intragovernmental Accounts Receivable / Reimbursable	Both IPAC payment and DFAS disbursing office processed payments for receivable. (IPAC)	9	Potential duplicate payments identified through use of automated detection program.	Validate that automated detection program identifies potential duplicate payments.	Confirm that adequate data is available so that the automated detection program captures all potential duplicate payments.	Yes	An inspection of the monthly reports and daily worksheets worked by the accounting technicians will be reviewed to ensure that the detection program ran as required on a daily basis and the potential duplicates researched within the same day. Any errors will be identified and documented. Any day which the	Yes	Low (no change)	Test work resulted in zero exceptions. All interviewed personnel and reviewed documentation followed the expected internal control procedures. Assessed preliminary control risk is properly

Control Assessment										
Entity:	Accounts Receivable / Reimbursable									
Preparer:										
Account Line:	Reimbursable									
Business Cycle, Accounting +/- Application	Risk	Control Number	Internal Control Currently In Place	1 Control Test Objective	2 Description of Design Test	3 Was Control Design Effective?	4 Description of Control Operation Test	5 Was Control Operation Effective?	6 New Control Risk Level	7 Test Results
							detection program did not run will also be documented. Copies of the reports and worksheets will be retained as test documentation.			supported and remains Low.
//				//						
Intragovernmental Accounts Receivable / Reimbursable (cont.)	Transactions are not mapped to correct USSGL account	13		Request DFAS – DDRS to provide test results for testing mapping procedures.						

## **Section D: Test Plan Development**

Low risk key controls must be tested to verify the effectiveness of the controls identified in the Risk Analysis.

Testing – Procedures to determine, through observation, examination, verification, sampling, or other methods, whether an internal control is working as intended.

The goal of testing internal controls is to validate that the controls are functioning effectively and address the relevant control objectives and assertions. The purpose of the test plan is to document testing procedures to provide evidence of the operating effectiveness of each control and to identify lapses in implementations of these controls.

The step by step description of the process is described within the test plan template on page 32 in Part II in this annual guidance.

### **Sample Test Plans and Results**

This Test Plans should be completed as of the May 1<sup>st</sup> submission; however, results are not required. It is assumed tests may not have been completed by May 1<sup>st</sup>. Test results (see pp. 60-64 in Part II of this annual guidance) are to be entered in Column #7 of the Control Analyses Spreadsheet for the June 30<sup>th</sup> submission. Also, note that while there are more control points indicated on the Risk Assessment, only the controls assessed as Low are being tested, because for the controls assessed as high, the component should prepare corrective action plans to reduce the risk of that control.

During the testing period, the preparer records the Test Results Summary in the final row on the Test Plan sheet. However, it is not necessary for the components to submit the Completed Test Plan Sheet to the FIAR Directorate. The preparer should briefly report the Test Plan findings in Column #7 of the Control Analyses. Completed Test Plans with results will be maintained by the component Senior Assessment Team for audit support.

Test Plan - [Control]	
Entity: DAA	
Preparer: Ima Nobaud	
Acct Line: Accounts Receivable/Reimbursable	
Control #:	6
Risk	MIPR authorization is exceeded.
Internal Control Currently in Place	Monthly reconciliation of the subsidiary records to the general ledger balances are accomplished and documented. Flag execution of order amount at 85%.
Control Type	Manual and automated
Control Frequency	Monthly
Testing Period	1 Oct 2006 – 30 May 20007
Test Method	Inspection
Documentation Location	HQ Resource Management Office
Population and Sample Size	Population: 187 MIPRs/orders x 12/yr =2,244, Sample Size: 30 MIPRs
Criteria for Effectiveness/ Tolerance Rate	Tolerance Rate: 2 (5% of 30 samples = 1.5 rounded up to 2)
Test Description	1) Observe how technician verifies that the amount to be obligated does not exceed the amount originally authorized in the MIPR/order. 2) Inspect records to validate reconciliation of MIPR amount to costs captured+ anticipated costs to complete order.
Test Result Summary	Testing resulted in zero deviations/errors; 30 of 30 sample items tested (100%) followed internal control procedures. All obligating documents against the 30 (incoming reimbursable) MIPRs/orders reviewed confirmed the amount obligated did not exceed the (incoming reimbursable) MIPR/order authority. Reconciliation documents included calculations of costs captured plus future anticipated costs to compare against MIPR amount. Assessed preliminary control risk is properly supported and remains Low.

Test Plan - [Control]	
Entity: <i>DAA</i>	
Preparer: <i>Shawn Didit</i>	
Acct Line: <i>Accounts Receivable/Reimbursable</i>	
Control #:	<i>8a &amp; 8b</i>
Risk	<i>Customer invoiced for incorrect amount of goods or services received.</i>
Internal Control Currently in Place	<i>Reconcile MIPR to invoice. System edits capture costs for billing.</i>
Control Type	<i>Manual and Automated</i>
Control Frequency	<i>Monthly and Continuous</i>
Testing Period	<i>1 Oct 2006- 30 May 2007</i>
Test Method	<i>Inspection</i>
Documentation Location	<i>Accounting Office, DFAS</i>
Population and Sample Size	<i>Population = 187 MIPRs x monthly billing to completion ~1,122. Sample size = 30 billings</i>
Criteria for Effectiveness/ Tolerance Rate	<i>Tolerance Rate: 1 (3% of 30 samples = .9 rounded to 1)</i>
Test Description	<i>1. Obtain all supporting documentation for the billing. 2. Verify that adequate documentation is on file to support billing. 3. Review 30 random cost transactions to determine if all transactions are billed to a customer.</i>
Test Strategy	<i>Tests will show that costs performed by MIPR code are collected to that MIPR and billed to the correct customer and that all costs are charged to an order.</i>
Test Result Summary	<i>Test work resulted in 2 exceptions of 30 samples. Assessed preliminary control risk of low is not properly supported.</i>

Test Plan - [Control]	
Entity: DAA	
Preparer: Shawn Didit	
Acct Line: Accounts Receivable/Reimbursable	
Control #:	9
Risk	Both IPAC payment and DFAS disbursing office processed payments to collect for receivable. (IPAC).
Internal Control Currently in Place	Potential duplicate collections identified through use of automated detection program.
Control Type	Automatic
Control Frequency	Continuous
Testing Period	1 Oct 2006 – 30 May 2007
Test Method	Re-performing
Documentation Location	DFAS Disbursing and Accounting Offices
Population and Sample Size	The population is ~ 1,122 collections. The sample size is 30.
Criteria for Effectiveness/ Tolerance Rate	The acceptable tolerance rate is set at 5%; (5% of 30 samples =1.5 rounded to 2), any errors resulting in a percentage higher than 5% will be deemed unacceptable and will require an increase to the control risk factor.
Test Description	An inspection of the monthly reports and daily worksheets worked by the accounting technicians will be reviewed to ensure that the detection program was run as required on a daily basis and the potential duplicates researched within the same day. Any errors will be identified and documented. Any day which the detection program did not run will also be documented. Copies of the reports and worksheets will be retained as test documentation.
Test Strategy	Testing will validate that the automated detection system and detection run controls are in place and detect duplicate collections.
Test Result Summary	Test work resulted in zero exceptions. All interviewed personnel and reviewed documentation followed the expected internal control procedures. Assessed preliminary control risk is properly supported and remains Low.

## **Section D**

OSD Analyst Checklists for accepting Component Deliverables:

- Process Narratives, Flow Charts, and Organizational Charts for the Assigned Implementation Areas, Component-level Environment Control Document such as a Management Code of Conduct or Ethics Policy, SAT membership and Charter
- Inherent Risk Analyses through Column 10, FISMA Report (if applicable),
- Internal Controls and Test Plan Methodology: Complete Risk Analysis Forms (through Column 13)
- Detailed Test Plans (w/o Results) or Corrective Action Plans for “High Risk” Controls
- Control Analyses Forms (w/ test results)

## Flowchart Checklist

<b>Component</b>		<b>Completed By</b>		
<b>Process</b>		<b>Date</b>		
<b>No.</b>	<b>Criteria or Requirement</b>	<b>YES</b>	<b>NO</b>	<b>Notes/ Action Required</b>
	<b>General</b>			
1	Does the deliverable include a transmittal memorandum signed by the chair of the Component's Senior Assessment Team?			
2	Does the deliverable include flowcharts, process narratives and the entity's organizational chart?			
3	Does the deliverable include the name, phone number and e-mail address of an operational point of contact?			
4	Does every page of the deliverable have a footer with the name of the Component?			
5	Does the deliverable include the organization's code of conduct or ethics policy, a list of SAT members with titles, and the SAT Charter?			
	<b>Flowcharts</b>			
6	Are flowcharts in Microsoft Word or Excel?			
7	Are flowcharts presented in swim-lane format?			
8	Do flowchart swim-lane headers include the names of the organizations or offices performing the functions within the lane? Headers should <u>never</u> be functions.			
9	Do the steps in the flowchart include the numbers of the associated step in the process narrative?			
10	Do flowcharts include manual processes and system processes? Flowcharts should not be computer system flow diagrams. For clarification, identify the names of any systems and reports.			
11	Do the flowcharts capture processes from the point of origin to the financial statements and then back to the point of origin?			



<b>12</b>	Are the names of the systems and reports identified on the flowcharts?			
	<b>Organizational Charts</b>			
<b>13</b>	Do organizational charts identify the chain of command for the departments explained in the flowcharts? All organizational offices shown in the flowcharts should be identified in the organizational chart.			
	<b>Process Narratives</b>			
<b>14</b>	Does the process narrative have the preparers name and is the process owner's name evident on the process narrative?			
<b>15</b>	Are the steps in the process narrative numbered? These numbers should also be included in the flowcharts (see step 9 above).			
<b>16</b>	Do narratives explain the steps in the process which cause an operational event to become a financial transaction?			
<b>17</b>	Does every process identified on the flowchart have an associated description in the narrative?			

## Risk Assessment Checklist

<b>Component</b>		<b>Completed By</b>	
<b>Process</b>		<b>Date</b>	
<b>No.</b>	<b>Criteria or Requirement</b>	<b>YES</b>	<b>NO</b>
	<b>General</b>		
<b>1</b>	Does the deliverable include a transmittal memorandum signed by the chair of the Component's Senior Assessment Team?		
	<b>Risk Assessment</b>		
<b>2</b>	Is the Risk Analysis completed on the DoD Risk Analysis form?		
<b>3</b>	Are columns 1 through 10 of the Risk Analysis Form completed?		
<b>4</b>	Does every risk have a control number associated with it from the process flowcharts?		
<b>5</b>	Have system risks been identified? (i.e., completeness, accuracy, validity and restricted access been addressed for financial systems?)		
<b>6</b>	Do the risks identified relate to a financial assertion? (Existence or Occurrence, Completeness, Rights and Obligations, Valuation or Allocation, Presentation or Disclosure).		
<b>7</b>	Does every risk statement include the cause and effect?		
<b>8</b>	Are there any risks that have not been identified where the process crosses different areas of responsibility? Please note that most Inherent Risk will be classified as high on the Risk Analysis Form.		
<b>9</b>	Are the identified Inherent Risks reasonable in comparison to the other Components?		
<b>10</b>	Does the identified Inherent Risk adequately explain what could go wrong from a financial reporting perspective?		

### Internal Control Identification and Preliminary Test Method

<b>Component</b>		<b>Completed By</b>	
<b>Process</b>		<b>Date</b>	
<b>No.</b>	<b>Criteria or Requirement</b>	<b>YES</b>	<b>NO</b>
<b>General</b>			
1	Does the deliverable include a transmittal memorandum signed by the chair of the Component's Senior Assessment Team?		
2	Are all columns of the Risk Analysis form completed? (including the columns previously completed during the risk assessment process)		
<b>Internal Controls</b>			
3	Are all "high" Inherent Risks addressed to identify key internal controls?		
4	Are all "high" control risk test plan data fields left blank? Controls classified as "high risk" should not be tested. Rather they will have corrective action plans created.		
5	Do the internal controls link to at least one risk?		
<b>Test Methods</b>			
6	Are test methods appear adequate for determining the effectiveness of internal controls over the Inherent Risk?		

### Test Plan Checklist

<b>Component</b>		<b>Completed By</b>	
<b>Process</b>		<b>Date</b>	
<b>No.</b>	<b>Criteria or Requirement</b>	<b>YES</b>	<b>NO</b>
	<b>General</b>		
1	Does the deliverable include a transmittal memorandum signed by the chair of the Component's Senior Assessment Team?		
2	Is the name of the Component and name of person completing the test plan identified?		
	<b>Test Plans</b>		
3	Is the DoD Test Plan form used?		
4	Are all blocks completed in the test plan template as directed by the A-123 Appendix A FY2007 Guidance?		
5	Are test plans developed for all low control risks?		
6	Are the associated control numbers identified in the process flowchart referenced on the test plans?		
7	Is the associated risk identified during the inherent risk analysis referenced on the test plan?		
8	Are the testing period and method clearly identified on the test plan?		
9	Does the test description explain the criteria for measuring the effectiveness of the test?		
10	Has the control universe been disclosed on the test plan?		
11	Does the sample size provide a representative sampling of the population?		
12	Does the test strategy describe how the test plan will be performed? The testing approach should define the nature, timing, and extent of testing necessary to provide sufficient evidence to support management's assertion.		

## GLOSSARY

**Account/Line Item/Event:** Indicates what the business process results in an increase or decrease of the financial value for a financial report line item.

**Assertion:** Management representations that are embodied in financial transactions. The assertions can be either explicit or implicit and can be classified into the following broad categories:

Existence or Occurrence: Management represents that all financial components actually existed at a given date or occurred during the accounting period.

Completeness: Management represents that all transactions and accounts that should be presented in the financial reports are included.

Rights and Obligations: Management represents that recorded assets are the rights of the entity and that recorded liabilities are the obligations of the entity at a given date.

Valuation or Allocation (Accuracy): Management represents that assets, liabilities, revenues, and expenses have been included in the financial reports at appropriate amounts.

Presentation and Disclosure (Reporting): Management represents that the financial reports' components are properly classified, described, and disclosed.

**Business Cycle, Accounting Application:** Indicates a specific business cycle or accounting transaction that is assessed in this particular business process. OUSD(C) has identified specific business cycles/accounting applications for use in the implementation areas' risk analysis to assist managers in identifying processes impacting account balances. OUSD(C) will provide the business cycles/accounting applications for other financial reporting line items in the future.

**Control Environment:** The organizational structure and culture created by management and employees to sustain organizational support for effective internal control.

**Control Risk:** The risk that a material misstatement could occur in an assertion and will not be prevented or detected and corrected on a timely basis by the entity's internal control. The use of professional judgment is essential in assessing control risk.

Low Control Risk: The preparer believes that controls WILL prevent or detect any aggregate misstatements that could occur in the assertion in excess of design materiality (low risk of misstatement).

High Control Risk: The preparer believes that controls will PROBABLY NOT prevent or detect any aggregate misstatements that could occur in the assertion in excess of design materiality (high risk of misstatement).

**Inherent Risk:** The susceptibility of an assertion to a material misstatement, assuming that there are no related internal controls. This susceptibility can be categorized as low or high.

**Key Business Process:** Process or function within an assessable unit that materially affects financial report balances.

**Key Control(s):** The control(s) that is/are identified to ensure that the key process(es) is/are performed completely, accurately, and correctly for the assessable unit. There can be as few as one key control, or there can be multiple key controls. Key controls are those controls that are expected to have the greatest impact on meeting the objectives of management.

**Management Process Owner:** Component or organization responsible for performing the process.

**Population:** Total number of times a control is performed within a given time period.

**Sample Size:** Number of controls tested from a given population.

**PART III**

**SCORECARD INFORMATION FOR THE  
FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT (FMFIA)  
ANNUAL STATEMENT OF ASSURANCE**

**FISCAL YEAR 2007**

For the Overall Statement of Assurance, there are five categories scored in FY 2007.

- Timeliness
  - Was the statement of assurance received according to the suspense, ahead or behind the suspense date?
  - Late submission puts the Department at risk of meeting the Office of Management and Budget's deadlines.
  - Extremely late reports are an indication of poor program execution.
  - Were the DoD Component's financial reporting requirements timely?
- Format
  - Was the statement of assurance accurate, complete, and easy to read?
  - Was the statement compliant with guidance?
  - Did the Head or Principal Deputy sign the statement and is the statement addressed to the Secretary of Defense?
- Program Execution
  - Does the statement describe evidence indicating that the Managers' Internal Control Program is executed at all levels of the Component?
  - To what extent is the Component using innovative methods to reach all levels of the organization?
  - Does the program execution support a timely submission with an acceptable format and prompt resolution of weaknesses?
  - Is the Component including all subordinate organizations as required?
  - Is there evidence that the Component is actively conducting an internal public awareness campaign similar to the DoD Check It campaign?
- Training
  - Does the statement describe evidence of MIC Program training given at all levels of the Component?
  - What is the extent to which the Component uses innovative methods to reach all levels of the organization?
  - Is the Component sufficiently training all Component personnel?
- Material Weakness Reporting Activity
  - Does the statement describe progress toward correcting identified material weaknesses promptly?
  - Does the statement indicate resolution of all delinquent weaknesses? Delinquent weaknesses are UNACCEPTABLE.
  - Does the statement clearly show that the Component conducted a robust assessment of the internal controls?
  - Is the Component forthrightly reporting weaknesses, especially those issues where the Department is criticized by an outside stakeholder such as the Government Accountability Office (GAO) or the Office of Management and Budget (OMB) for omitting the issue as a material weakness?
  - Has the Component obtained an unqualified opinion with no material weaknesses outstanding?
  - Has the Component obtained an unqualified or qualified opinion with material weaknesses which are being promptly resolved?



The tables below describe the criteria used to score the statements.

<b>Timeliness Category</b>	
<b>+3 points (Blue)</b>	<ul style="list-style-type: none"> <li>Received on or before August 24, 2007 by close of business (COB).</li> </ul>
<b>+2 points (Green)</b>	<ul style="list-style-type: none"> <li>Received after August 24, 2007 or by COB on September 4, 2007.</li> </ul>
<b>+1 point (Amber)</b>	<ul style="list-style-type: none"> <li>Received after September 4, 2007 or by COB on September 6, 2007.</li> </ul>
<b>-1 point (Red)</b>	<ul style="list-style-type: none"> <li>Received after September 6, 2007 or by COB on September 17, 2007.</li> </ul>
<b>-10 points (Black)</b>	<ul style="list-style-type: none"> <li>Received after September 17, 2007.</li> </ul>

<b>Format Category</b>	
<b>+3 points (Blue)</b>	<ul style="list-style-type: none"> <li>Best in Category – Exceptional in all aspects (Accurate, complete, easy to read, and represents a good model to benchmark).</li> </ul>
<b>+2 points (Green)</b>	<ul style="list-style-type: none"> <li>No revisions required and not necessary to ask for explanation from Component.</li> </ul> <p style="text-align: center;">AND</p> <ul style="list-style-type: none"> <li>Acceptable in all aspects (Accurate, complete, fairly easy to read, and represents an acceptable model).</li> </ul>
<b>+1 point (Amber)</b>	<ul style="list-style-type: none"> <li>Returned for correction or requested Component to clarify any aspect of the statement.</li> </ul> <p style="text-align: center;">OR</p> <ul style="list-style-type: none"> <li>Unsatisfactory in at least one aspect (Not accurate, not complete, not easy to read, or does not represent an acceptable model).</li> </ul>
<b>-1 point (Red)</b>	<ul style="list-style-type: none"> <li>Extensive changes required.</li> </ul> <p style="text-align: center;">OR</p> <ul style="list-style-type: none"> <li>Incorrectly stated the opinion, i.e., provided an unqualified statement that should have been qualified.</li> </ul> <p style="text-align: center;">OR</p> <ul style="list-style-type: none"> <li>Statement is noncompliant in one or more aspects (Component failed to follow provided guidance in preparing statement).</li> </ul>

<b>Program Execution Category</b>	
<b>+4 points (Purple)</b>	<ul style="list-style-type: none"> <li>The Best Internal Control Awareness Campaign(s) as evidenced in the Statement(s) of Assurance.</li> </ul>
<b>+3 points (Blue)</b>	<ul style="list-style-type: none"> <li>Best in Category – Component reports at least one innovative measure <b><u>that has not been previously reported</u></b> to enhance Component-wide program execution.</li> <li>Excludes any Component that scored a RED in the Material Weakness Category.</li> </ul>
<b>+2 points (Green)</b>	<ul style="list-style-type: none"> <li>Statement clearly indicates that the Managers' Internal Control (MIC) Program is executed at all levels (Component-wide program execution).</li> </ul>
<b>+1 point (Amber)</b>	<ul style="list-style-type: none"> <li>Statement has limited evidence of Component-wide program execution.</li> </ul>
<b>-1 point (Red)</b>	<ul style="list-style-type: none"> <li>No evidence of Component-wide program execution in statement.</li> <li>Statement is over 15 days late (Late submission reflects poor program execution).</li> </ul>

<b>Training Category</b>	
<b>+3 points (Blue)</b>	<ul style="list-style-type: none"> <li>Best in Category – Component reports at least one reported innovative measure <b>that has not been previously reported</b> which enhances training of the Managers' Internal Control (MIC) Program Component-wide.</li> </ul>
<b>+2 points (Green)</b>	<ul style="list-style-type: none"> <li>Evidence in statement of Component-wide MIC Program training performed for Component managers, MIC Program coordinators, and assessable unit managers</li> </ul>
<b>+1 point (Amber)</b>	<ul style="list-style-type: none"> <li>Statement reflects training for different Component audiences but not all listed for Green score.</li> </ul>
<b>-1 point (Red)</b>	<ul style="list-style-type: none"> <li>Statement provides no evidence of Component-wide MIC Program training.</li> </ul>

<b>Material Weakness Reporting Activity Category</b>	
<b>+5 points (White)</b>	<ul style="list-style-type: none"> <li>85% or more of weaknesses corrected on time in FY 2007 as targeted in FY 2006 Statement of Assurance. (There must be at least 2 weaknesses corrected.)</li> </ul> <p style="text-align: center;">AND/OR</p> <ul style="list-style-type: none"> <li>Unqualified opinion with no material weaknesses.</li> </ul> <p style="text-align: center;">OR</p> <ul style="list-style-type: none"> <li>70% or more are corrected on time and at least two weaknesses are corrected in advance of target.</li> </ul> <p style="text-align: center;">OR</p> <ul style="list-style-type: none"> <li>None due for correction but more than two weaknesses are corrected in advance of target.</li> </ul>
<b>+4 points (Purple)</b>	<ul style="list-style-type: none"> <li>80% to 84% of weaknesses corrected on time. (There is no qualification on the number of weaknesses that must be corrected.)</li> </ul> <p style="text-align: center;">AND/OR</p> <ul style="list-style-type: none"> <li>Unqualified opinion with any material weaknesses outstanding.</li> </ul> <p style="text-align: center;">OR</p> <ul style="list-style-type: none"> <li>60% to 69% are corrected on time and more than one weakness corrected in advance of target.</li> </ul> <p style="text-align: center;">OR</p> <ul style="list-style-type: none"> <li>None due for correction but at least two weaknesses corrected in advance of target.</li> </ul>
<b>+3 points (Blue)</b>	<ul style="list-style-type: none"> <li>75% to 79% of weaknesses are corrected on time. (There is no qualification on the number that must be corrected.)</li> </ul> <p style="text-align: center;">OR</p> <ul style="list-style-type: none"> <li>50% to 59% are corrected on time and at least one weakness corrected in advance of target.</li> </ul>
<b>+2 points (Green)</b>	<ul style="list-style-type: none"> <li>60% to 74% are corrected on time.</li> </ul> <p style="text-align: center;">OR</p> <ul style="list-style-type: none"> <li>If none due for correction in FY 2007: <ul style="list-style-type: none"> <li>At least one new weakness reported or one weakness reported as corrected in last three years.</li> </ul> </li> </ul> <p style="text-align: center;">OR</p> <ul style="list-style-type: none"> <li>Statement indicates at least two deficiencies found, that do not warrant reporting as material weaknesses and statement describes actions to resolve. (Must use format described in paragraphs on page 13 of Part I.)</li> </ul>

<b>Material Weakness Reporting Activity Category (continued)</b>	
<b>+1 point (Amber)</b>	<ul style="list-style-type: none"> <li>50% to 59% corrected on time. OR</li> <li>If none due for correction during FY 2007 and no new or old weaknesses in last three years, the statement of assurance must indicate at least one deficiency and actions to resolve. (Must include corrective actions using the format in paragraph s., page 13 of Part I.) OR</li> <li>Regardless of the percentage corrected, Component has one incident where an outside stakeholder has criticized the DoD for omitting a material weakness and the Component subsequently omitted the weakness from the next statement of assurance.</li> </ul>
<b>-1 point (Red)</b>	<ul style="list-style-type: none"> <li>Less than 50% of weaknesses corrected. OR</li> <li>No weaknesses reported as new in past three fiscal years. AND</li> <li>No weaknesses corrected in past three fiscal years. AND</li> <li>No deficiencies with corrective actions discussed in statement of assurance. OR</li> <li>Delinquent weaknesses resulting in a REDUCTION OF TOTAL SCORE as follows: (A component with remaining delinquent weaknesses would receive the next lower score in the total score of this category. For example, a Component who resolved 4 of 4 weaknesses on time would usually receive a White score of 5 points. However, if that Component also had one or more delinquent weaknesses remaining open, the total score would be reduced by one color resulting in a Purple score of 4 points.) OR</li> <li>Regardless of the percentage of corrected on time, the Component has more than one incident where an outside stakeholder has criticized the DoD for omitting a material weakness and the Component subsequently omitted the weakness from the next statement of assurance.</li> </ul>